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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1930

No. 334

HANS REES' SONS, INC., APPELLANT,

vs.

STATE OF NORTH CAROLINA ON THE RELATION OF ALLEN J. MAXWELL, COMMISSIONER OF REVENUE

APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA

FILED AUGUST 5, 1930

(35,256)

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOVEMBER 17, 1930

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BEFORE COMMISSIONER OF REVENUE OF NORTH CAROLINA

PETITION—Filed Aug. 17, 1927

To the Commissioner of Revenue of the State of North Carolina:

Hans Rees' Sons, Inc., a corporation organized and existing under and by virtue of the Laws of the State of New York, in accordance with Section 340 of Chapter 80 of the Public Laws of 1927 of the State of North Carolina, hereby petitions for a rehearing and readjustment of the income tax assessed against it for the years 1923, 1924, 1925 and 1926, and in support of said petition shows the following facts:

1. In accordance with Section 400, Chapter 4 of the Public Laws of 1923 of North Carolina, and amendments thereto, your petitioner on or about the 11th day of March, [fol. 2] 1924, duly filed with the Commissioner of Revenue, of North Carolina, a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of your petitioner for the calendar year 1923 to be $230,279.40. Said report also showed the nature of petitioner's business and the location and amount of its assets. A copy of said report is hereto annexed and marked Exhibit A. In said report the petitioner allocated all of its property except its good will between North Carolina and property wherever located, and, as appeared from said report, 57.32% of its assets were allocated as located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina as income having its source in North Carolina, on the theory that income could fairly be apportioned in proportion to location of assets, gave North Carolina income of $131,996.15. Thereafter a tax of 3% upon said apportioned net income was assessed against your petitioner, amounting to $3,959.88, which tax your petitioner duly paid on the 11th day of March, 1924, to the Commissioner of Revenue at Raleigh, North Carolina, the officer

duly designated to collect said taxes in accordance with Section 500 of Chapter 4 of the Public Laws of 1923 of North Carolina, and amendments thereto. Thereafter the said Commissioner re-examined and audited said return and found the total net income shown therein to be correct, except that debts amounting to $2,552.50 reclaimed, but not included in the original report, were added by the Commissioner, and dividends amounting to $904.00 were deducted, making a final corrected net income of $231,927.90. But he held that the apportionment of net income to North Carolina should be in proportion to the location of physical assets, and, disregarding the location of accounts receivable, money in bank, and all other assets, except tangible physical properties, he allocated to North Carolina 83.7% of said physical properties, and, applying this percentage as the allocation of income, apportioned to North Carolina as [fol. 3] income having its source in said State 83.7% of the total net income for 1923, or the sum of $194,123.65. Annexed hereto and marked Exhibit B is a copy of the petitioner's balance sheet showing the value of all petitioner's assets in 1923. Annexed hereto and marked Exhibit C is a copy of a letter from the Commissioner showing the basis upon which he made the apportionment of physical assets aforesaid. The Commissioner of Revenue accordingly assessed a tax against your petitioner of 3% on $194,123.65, said apportioned net income, amounting to $5,823.61, and, crediting against said tax $3,959.88 paid on the 11th day of March, 1924, demanded payment of $1,863.73, additional income tax for 1923 with additional interest thereon of $260.92, or a total additional payment of $2,124.65. Thereafter, on or about the 13th day of August, 1926, your petitioner paid said additional tax but under duress and compulsion and upon the express protest that the said additional tax was illegal and void and that your petitioner should not be compelled to pay the same, and reserved the right to contest the legality of said tax in subsequent proceedings to be taken in accordance with law.

2. In accordance with Section 400, Chapter 4 of the Public Laws of 1923 of North Carolina and amendments thereto, your petitioner on or about the 14th day of March, 1925, duly filed with the Commissioner of Revenue, of North Caro-

lina, a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of your petitioner for the calendar year of 1924 to be $253,921.82. Said report also showed the nature of petitioner's business and the location and amount of its assets. A copy of said report is annexed hereto and marked Exhibit D. In said report the petitioner allocated all of its property, except its good will, between North Carolina and property wherever located, and, as appeared from said report 68.55% of its assets were allocated as located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina as income having its source in North Carolina, on the theory that [fol. 4] income could fairly be apportioned in proportion to location of assets, gave North Carolina income of $174,063.41. Thereafter a tax of 3% upon said apportioned net income was assessed against your petitioner amounting to $5,221.90, which tax your petitioner duly paid on the 14th day of March, 1925, to the Commissioner of Revenue, at Raleigh, North Carolina, the officer duly designated to collect said taxes, in accordance with Section 500 of Chapter 4 of the Public Laws of 1923 of North Carolina, and amendments thereto. Thereafter the said Commissioner re-examined and audited said return, and found the total net income shown therein to be correct, except for the sum of $3,959.88 covering North Carolina income tax paid, which the Commissioner held was not deductible under the North Carolina Law. This made a total corrected net income of $257,881.70. But he held that the apportionment of net income to North Carolina should be in proportion to the location of physical assets, and, disregarding the location of accounts receivable, money in banks, and all other assets except tangible physical properties, be allocated to North Carolina 85.89% of said physical properties, and, applying this percentage as the allocation of income, apportioned to North Carolina as income having its source in said State 85.89% of the total net income for 1924, or the sum of $221,494.59. Annexed hereto and marked Exhibit E is a copy of petitioner's balance sheet showing the value of all petitioner's assets in 1924, upon which balance sheet this report was based, but which balance sheet was later found to be incorrect. A copy of petitioner's corrected balance

sheet for the year 1924 is annexed hereto and marked Exhibit F. Annexed hereto and marked Exhibit C is a copy of a letter from the Commissioner showing the basis upon which he made the apportionment of physical assets aforesaid. The Commissioner of Revenue accordingly assessed a tax against your petitioner of 3% on $221,494.59, said apportioned net income, amounting to $6,644.84, and, crediting [fol. 5] against said tax $5,221.90 paid on the 14th day of March, 1925, demanded payment of $1,422.94, additional income tax for 1924 with additional interest thereon of $113.83, or a total additional payment of $1,536.77. Thereafter, on or about the 13th day of August, 1926, your petitioner paid said additional tax but under duress and compulsion and upon the express protest that the said additional tax was illegal and void and that your petitioner should not be compelled to pay the same, and reserved the right to contest the legality of said tax in subsequent proceedings to be taken in accordance with law.

3. In accordance with Section 400, Chapter 101 of the Public Laws of 1925 of North Carolina, and amendments thereto, your petitioner, on or about the 15th day of March, 1926, duly filed with the Commissioner of Revenue of North Carolina a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of your petitioner for the calendar year 1925 to be $139,043.43. Said report also showed the nature of petitioner's business and the location and amount of its assets. A copy of said report is annexed hereto and marked Exhibit G. In said report the petitioner allocated all of its property, except its good will, between North Carolina and property wherever located, and, as appears from said report, 62.09% of its assets were allocated as located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina as income having its source in North Carolina, on the theory that income could fairly be apportioned in proportion to location of assets, gave North Carolina income of $86,332.06. Thereafter a tax of 4% upon said apportioned net income was assessed against your petitioner, amounting to $3,453.28, which tax your petitioner duly paid on the 15th day of March, 1926, to the Commissioner of Revenue at Raleigh, N. C., the officer duly designated to

collect said tax, in accordance with Section 500 of Chapter 101 of the Public Laws of 1925 of North Carolina, and [fol. 6] amendments thereto. Thereafter the said Commissioner re-examined and audited said return, and increased the total net income shown thereon from $139,043.43 to $141,339.53 by adding $1,111.49 for freight and $1,084.61 for bad debts collected but not included in petitioner's report and $100.00 to cover a mathematical error in the original report, or a total of $2,296.10; to this net income of $141,339.53 the Commissioner added $5,521.90 to cover North Carolina income taxes which had been deducted in petitioner's report but which the Commissioner held were not deductible under the North Carolina statute. The Commissioner also held that the apportionment of net income to North Carolina should be in proportion to the location of physical assets, and reduced the whole value of petitioner's property, for the purpose of allocation, from $2,293,929.85 to $2,147,097.13, although the value of all the petitioner's physical assets was only $1,840,417.61, and disregarding the location of accounts receivable, money in banks, and all other assets, except tangible physical properties, he allocated to North Carolina 66.32% of said physical properties, and, applying this percentage as the allocation of income, apportioned to North Carolina as income having its source in said State 66.32% of the total net income for 1925, or a total of $97,217.13. Annexed hereto and marked Exhibit H is a copy of petitioner's balance sheet showing the value of all petitioner's assets in 1925. Annexed hereto and marked Exhibit C is a copy of a letter from the Commissioner showing the basis upon which he made the apportionment of physical assets aforesaid. The Commissioner of Revenue accordingly assessed a tax against your petitioner of 4% on $97,217.13, said apportioned net income, amounting to $3,888.68, and, crediting against said tax $3,453.28 paid on the 15th day of March, 1926, demanded payment of $435.40 additional income tax for 1925, with additional interest thereon of $8.71, or a total additional payment of $444.11. Thereafter, and on or about the 13th day of August, 1926, your petitioner paid [fol. 7] said additional tax, but under duress and compulsion, and upon the express protest that the said additional tax was illegal and void and that your petitioner should not be compelled to pay the same, and reserved the right to con-

test the legality of said tax in subsequent proceedings to be taken in accordance with law.

4. In accordance with the provisions of Chapter 101 of the Public Laws of 1925 of North Carolina, your petitioner, on or about April 11th, 1927, after having obtained from the Commissioner of Revenue of North Carolina an extension of time for the filing of said report until April 15th, 1927, duly filed with the Commissioner of Revenue of North Carolina a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of your petitioner for the calendar year of 1926 to be $106,727.55. Said report also showed the nature of petitioner's business and the location, and amount of its assets. A copy of said report is hereto annexed and marked Exhibit I. In said report your petitioner apportioned its net income in North Carolina in proportion to the location of physical assets, disregarding the location of accounts receivable, money in bank, and all other assets, except tangible physical properties, as was required by the Commissioner of Revenue of North Carolina in connection with the 1923, 1924 and 1925 taxes as stated in the preceding paragraphs herein; and upon that basis allocated to North Carolina 85.53226% of its total income of $106,727.55, or a total net income apportioned to North Carolina of $91,286.48. Attached hereto and marked Exhibit J is a copy of the petitioner's balance sheet showing the value of all petitioner's assets in 1926. A tax was accordingly assessed against your petitioner of 4% on $91,286.49, said apportioned net income, or a total of $3,651.46, which your petitioner paid upon the express protest that said tax was illegal and void and that your petitioner was compelled to pay the same under duress and compulsion, and reserved the right to contest the legality of said tax in subsequent [fol. 8] proceedings to be taken in accordance with law. Said tax was thus paid under protest on the 11th day of April, 1927, after petitioner had obtained an extension of time for the payment thereof from the Commissioner of Revenue of North Carolina, to the Commissioner of Revenue of North Carolina, the officer designated in Chapter 101 of the Laws of 1925 to collect said tax.

5. Your petitioner is a corporation organized under the Laws of the State of New York, and is engaged in the busi-

ness of buying hides, tanning the hides into leather and selling the leather to customers throughout the United States. It owns a tannery and appurtenances at Asheville, North Carolina, where it performs substantially all of its manufacturing operations. Only a negligible amount of its hides or other raw materials are purchased in North Carolina. Its sales are practically none of them made from North Carolina and are substantially all made from its head office in New York. Practically all of its sales are made in interstate commerce by shipments to customers throughout the United States. Your petitioner's net income is derived from a continuous business consisting of buying the hides and other raw materials outside the State of North Carolina; manufacturing the hides into leather in the State of North Carolina; and selling the leather outside the State of North Carolina. Your petitioner concedes that the State of North Carolina can lawfully and constitutionally levy an income tax against your petitioner upon that portion of your petitioner's income that has its source in North Carolina, but it alleges that the State of North Carolina cannot constitutionally levy an income tax upon that portion of your petitioner's income that has its source outside the State of North Carolina. Your petitioner shows that in truth and in fact less than 25% of your petitioner's total net income can be apportioned to the manufacturing operations of your petitioner conducted within the State of North Carolina, and that the remaining 75% or more of your petitioner's total net income has its source wholly [fol. 9] without the State of North Carolina, and in fact arises from the merchandising operations of your petitioner conducted wholly without the State of North Carolina.

6. Your petitioner further shows that the income taxes assessed against your petitioner for the years 1923, 1924, 1925 and 1926 being based upon the apportionment of total net income to North Carolina of 83.7%, 85.89%, 66.32%, and 85.53226%, respectively, and the said statutes of the State of North Carolina imposing said taxes construed as authorizing said apportionment of income are illegal and void and repugnant to the Commerce Clause of Section 8, Article 1 and to the Fourteenth Amendment of the Federal Constitution, and your petitioner hereby draws in

question the validity of said tax and of the Laws of the State of North Carolina by virtue of which it is imposed, upon the ground that the rule of apportionment of income therein applied and provided is wholly arbitrary, unreasonable and void, and operates to impose an unlawful burden upon petitioner's interstate commerce and to deprive petitioner of its property without due process of law, and to deprive petitioner of the equal protection of the laws, all in violation of the provisions of the Federal Constitution hereinabove referred to.

7. Your petitioner shows that it has duly complied with all the provisions of law authorizing it to do business in North Carolina and has paid all taxes assessed against it in said State. Your petitioner further shows that the income taxes herein complained of are not commutation taxes or taxes levied in lieu of or to take the place of other taxes. On the contrary, your petitioner has paid other taxes in North Carolina as follows:

For the year 1923 your petitioner paid Asheville City taxes amounting to $9,434.46, Asheville City franchise tax of $150, County tax of $7,624.58, State franchise tax of $622.70, and taxes upon land amounting to $1,217.48, or a total of $19,049.22; for the year 1924 your petitioner paid [fol. 10] Asheville City taxes amounting to $9,014.08, Asheville City franchise tax of $150, County taxes of $5,874.86, State franchise tax of $573.20, and taxes upon land of $1,264.03, or a total of $16,876.17; for the year 1925 your petitioner paid Asheville City taxes of $10,969.47, Asheville City Franchise tax of $150, County taxes of $7,149.30, State franchise tax of $902.69, and taxes upon land amounting to $1,534.07, or a total of $20,705.53; for the year 1926 your petitioner paid Asheville City taxes of $11,107.56, City franchise tax of $150, County taxes of $9,501.56, State franchise tax of $902.69, and land taxes of $1,560.88, or a total of $23,222.69.

Your petitioner alleges, therefore, that it has paid full taxes other than income taxes upon all of its property owned and business transacted in North Carolina and it alleges that an income tax upon that portion of its income that has its source without the State of North Carolina cannot be justified or sustained as a measure of another kind of tax upon property or business which would otherwise not bear its fair share of taxation.

Wherefore your petitioner respectfully prays the Commissioner to grant a revision of the income taxes assessed against the petitioner for the years 1923, 1924, 1925 and 1926, pursuant to the provisions for revision by the Commissioner of Revenue contained in Sections 340 and 341 of Chapter 80 of the Public Laws of 1927 of North Carolina.

Hans Rees' Sons, Inc., by Harold B. Rees, Petitioner. Harkins & Van Winkle, Attorneys for Petitioner, Asheville, N. C. Louis H. Porter, of Counsel.

[fol. 11] *Duly sworn to by Harold B. Rees. Jurat omitted in printing.*

EXHIBIT A TO PETITION

Copy

North Carolina State Department of Revenue Foreign Corporation Income-tax Return for Calendar Year Ending December 31, 1923

Hans Rees' Sons, Inc., 39 Frankfort St., New York, N. Y.

Gross Income

1. Gross sales, less returns and allowances	$2,485,867 55	
Plus inventory at close of year	683,872 78	
[fol. 12]		$3,169,740 33
2. Less cost of raw materials	1,253,825 51	
Supplies used	406,203 78	

Wages and labor	268,951 95	
Total raw materials, wages and labor	1,928,981 24	
Plus inventory at beginning of year	722,176 59	
		2,651,157 83
Gross income from operation		$518,582 50
3. Gross income from operations other than trading or manufacturing: None.		
4. Taxable interest received from all sources: None.		
5. Rentals: None.		
6. Royalties: None.		
7. Income from sale of capital assets: None.		
8. Income received from partnership: None.		
9. Total dividends received from corporations, no part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each	$904 00	
10. Total dividends received from corporations, part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each	None	

11. Gross income from all other sources subject to tax	904 00	
[fol. 13]		
12. Total income, 3 to 11, inclusive		$904 00
13. Total gross income, 1 to 12		519,486 50
14. Total deductions (item 11, page 2)		289,207 10
15. Total net income		230,279 40
16. Net income taxable in North Carolina on basis percentage of property or receipts in this State as shown on page 2		$131,996 15
17. Tax due, 3 per cent of item 16		3,959 88

Page 2—Deductions

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business	140,926 14
2. Reasonable compensation of officers	48,100 00
3. Rentals or other payments required to be made as a condition of the continued use or possession, for the purpose of the trade or property to which the taxpayer has not taken, or is not taking title, or in which he has no equity	7,678 48
4. All interest paid during the income year on indebtedness, except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest	18,345 07
5. Taxes for the income year, except taxes on income and war profits and excess profit taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed	25,883 37
6. Dividends from stock in any corporation the income from which shall have been assessed and the tax on such income	

paid by the corporation under the provisions of this act; Provided, that when only part of the income of any corporation shall have been assessed [fol. 14] under this act only a corresponding part of the dividends received therefrom shall be deducted. Attach statement of such dividends.	
7. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.	
8. Loss from sale of capital assets.	
9. Debts ascertained to be worthless and charged off within the taxable year if the amount has previously been included in gross income in a return under this act	5,372.50
10. A reasonable allowance for depreciation and obsolescence	42,901.54
11. Total deductions	$289,207.10

Show Below

Total, fair cash value of real estate and tangible personal property in and out of the State on the date of the close of the taxable year	$1,582,297.99
Total, fair cash value of real estate and tangible personal property in this State on date of the close of the taxable year	906,964.73
Percentage of property in this State	.5732
Total gross receipts in and out of the State for the year ended on the date of the close of the taxable year.	
Total gross receipts in the State for the year ended on the date of the close of the taxable year.	
Percentage of receipts in this State, Section 201, Chapter 4, Public Laws, 1923.	
State amount income reported or to be reported to Federal Government for year covered by this report	230,827.90

[fol. 15] Schedule of Depreciation and Depletion No. 10

Kind of property:

Buildings: Original cost, plus additions and improvements, $216,191.81; rate, 4 and 2%; depreciation, 8616.67.

Machinery: Original cost, plus additions and improvements, $216,533.48; rate, 15 and 7½%; depreciation, 32262.19.

Delivery Equipment: Truck, $4,117.32 at 20%; mules and wagons, $1,728.00 at 10%. Original cost, plus additions and improvements, $5,845.32, depreciation, $172.80.

Tools, furniture and fixtures: Original cost, plus additions and improvements, $10,700.06, rate 10 and 5%, depreciation, $1,026.42. Total, $42,901.54.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated pursuant to the Revenue Act for 1923 and the regulations issued under authority thereof.

(Signed) H. B. Rees, President. (Signed) E. F. Gordon, Asst. Treasurer.

Sworn to and subscribed before me, this 11th day of March, 1924. (Signed) I. Wettlaufer.

Hans Rees' Sons—Notes

Reconciliation of Net Income with Federal Return

Income reported on Federal return	$230,827.90
Income from bad debts collected in 1923 in income before 1922	2,552.50
	$228,275.40
[fol. 16] Bad debts charged off above amount in North Carolina return, as they were in income before 1922	1,100.00
	$229,375.40
Dividends not taxed by U. S.	904.00
North Carolina return	$230,279.40

The valuations on buildings and machinery and the rates, were fixed by the Board of Appeals and Review of the Internal Revenue Department. The larger rate applies to figures at beginning of year and the half rate applies to additions during the year.

EXHIBIT B TO PETITION

Hans Rees' Sons, Inc., New York, N. Y.

Asset and Liability Statement

Assets, Dec. 31, 1923

Cash on hand	$150,494.77
Book accounts—good	267,090.80
Bills receivable	0.00
Due from employees	578.29
Insurance paid in advance	1,500.00
Interest paid in advance	307.10
Accounting paid in advance	800.00
Stocks and bonds	24,500.00
Merchandise stock in New York	208,536.03
Merchandise stock elsewhere	167,222.34
Hides, leather in process, bark, supplies, etc., at tannery	481,380.65
Bark lands	40,913.13
Real estate at Asheville	40,000.00
Building and machinery at Asheville	433,715.69
Delivery equipment at Asheville	5,845.32
[fol. 17] Tools, furniture and office improvements, N. Y.	28,270.83
Good will	100,000.00
	$1,951,154.95

Liabilities

Bills payable	$95,000.00
Accounts payable	7,678.13
Investment loans	80,938.15
Rent account	791.66
	$184,407.94
Reserve for accounts receivable	1,000.00

Reserve for discounts	8,480.01
Reserve for depreciation	257,769.85
Reserve for employers' liability	18,587.63
Reserve for insurance	3,532.00
Reserve for Federal taxes	35,000.00
Capital stock	1,000,000.00
Surplus	442,377.52
	$1,951,154.95
Quick assets, net over liabilities	$1,109,522.03

EXHIBIT C TO PETITION

State of North Carolina, Department of Revenue

Raleigh, August 9, 1926.

Hans Rees' Sons, 39 Frankfort Street, New York, N. Y.

GENTLEMEN: I am in receipt of your letter of July 30th and advise that the Deputy Commissioner in reporting additional income tax for the years 1923, 1924 and 1925 reported as follows:

[fol. 18] 1923

Income reported to this department was $230,279.40 to which was added debts reclaimed not included in original report of $2,552.50 and allowed dividends in the sum of $904.00, which left net income corrected to $231,927.90. You reported for the purpose of allocating income to this department total valuation of property of $1,582,297.99. He reported total value of the property allowable for allocation purposes consisting of inventories, land, buildings, machinery, equipment, furniture and fixtures of $1,148,-114.14. This operated to increase your percentage from .5732 to .837. This percentage of net income of $231,927.90 equals $194,123.65 taxable at 3% and results as follows:

Tax at 3%	$5,823.61
Previously paid	3,959.88
Balance	1,863.73
Interest	260.92
Total additional	$2,124.65

1924

For this year you reported $253,921.82 to which the deputy added income tax deducted, which is not allowable under the North Carolina Law, of $3,959.88, making total net income of $257,881.70. You reported assets as a whole for allocation purposes of $2,241,654.94. He reduced this amount to $1,792,110.61. For this year he also reduced property in North Carolina from $1,536,861.36 to $1,529,323.24, allowing in both instances only inventories, land, buildings, machinery, equipment, furniture, fixtures, etc. [fol. 19] This increased your percentage in North Carolina from .6855 to .8580. This percentage of the net income above stated makes income taxable to North Carolina $221,494.59 and results as follows:

Tax at 3%	$6,644.84
Previously paid	5,221.90
Balance	$1,422.94
Interest	113.83
Total additional	$1,536.77

1925

You reported as net income $139,043.43. The books showed income $141,339.53, plus State income tax deducted $5,221.90, making correct income $146,561.43. You reported property value as a whole for allocation purposes $2,293,929.85. After eliminating items included which are not permitted under the law this amount was reduced to $2,147,097.13 and percentage increased from .6209 to .6632. This percentage of the total net income is $97,217.13 and results as follows:

Tax at 4%	$3,888.68
Previously paid	3,453.28
Balance	435.40
Interest	8.71
Total additional	$444.11

I wish to state with reference to change in property values that under the law and decisions of this department (concurred in by the Attorney-General) that all cash, bills receivable, good will, stock in other corporations and property of like character is not allowed to be used as tangible property within the meaning of the Act for the purpose of allocating income to this State.

[fol. 20] I sincerely trust that the above is clear and that you will favor me with your check as requested in my previous letter.

Yours truly, (Signed) R. A. Doughton, Commissioner.

AEB-W.

EXHIBIT D TO PETITION

North Carolina State Department of Revenue

Foreign Corporation Income-Tax Return for Calendar Year Ending December 31, 1924

Hans Rees' Sons, Inc., Organized 1901. Tanning and Selling Leather, 39 Frankfort St., New York, N. Y.

Gross Income

1. Gross sales from trading or manufacturing, less returns and allowances		$2,109,021.39
Less costs of goods sold:		
(a) Inventory at beginning of year	$683,872.78	
(b) Merchandise bought for sale	1,593,359.88	
(c) Cost of mfg. or otherwise producing goods	247,479.07	

(d) Total of lines a, b, c	2,524,711.73	
(e) Less inventory at end of year	949,325.84	
		1,575,358.89
2. Gross profit from trading or Manufg. (Item 1, less cost of goods sold)		$533,662.50
3. Gross income from operations other than trading or manufacturing: None.		
[fol. 21] 4. Taxable interest received from all sources: None.		
5. Rentals: None.		
6. Royalties: None.		
7. Income from sale of capital assets: None.		
8. Income received from partnership: None.		
9. Total dividends received from corporations, no part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each	$904.00	
10. Total dividends received from corporations, part of which which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each: None.		
11. Gross income from all other sources subject to tax	1,658.36	
12. Total income, 3 to 11, inclusive		2,562.36

13. Total gross income, 1 to 12	536,224.86
14. Total deduction (item 11, page 2)	282,303.04
15. Net income (total)	253,921.82
16. Net income taxable in N. C. on basis percentage of property or receipts in this State as shown on page 2	174,063.41
17. Tax due, 4 per cent of item 16	5,221.90

Page 2—Deductions

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business	$144,635.50
2. Reasonable compensation of officers	55,000.00
[fol. 22] 3. Rentals or other payments required to be made as a condition of the continued use or possession, for the purpose of the trade or property which the taxpayer has not taken, or is not taking title, or in which he has no equity	7,678.47
4. All interest paid during the income year on indebtedness, except interest on obligations contracted for the purpose of non-taxable securities. Dividends on preferred stock shall not be deducted as interest	4,567.16
5. Taxes for the income year, except taxes on income and war profits and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed	25,378.02
6. Dividends from stock in any corporation, the income from which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only part of the income of any corporation shall have been assessed under this act only a corre-	

sponding part of the dividends received therefrom shall be deducted: None.	
7. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit: None.	
8. Loss from sale of capital assets: None.	
9. Debts ascertained to be worthless and charged off within the taxable year if the amount has previously been included in gross income in a return under this act	2,353.66
10. A reasonable allowance for depreciation and obsolescence	42,690.23
11. Total deductions	$282,303.04

[fol. 23]

Show Below

Total fair cash value of real estate and tangible personal property in and out of the State on the date of the close of the taxable year	$2,241,654.94
Total fair cash value of real estate and tangible personal property in this State on date of the close of the taxable year	1,536,861.36
Percentage of property in this State	68.55%
Total gross receipts in and out of the State for the year ended on the date of the close taxable year.	
Total gross receipts in the State for the year ended on the date of the close of the taxable year.	
Percentage of receipts in this State.	
State amount income reported or to be reported to Federal Government for year covered by this report	253,017.82

Schedule of Depreciation and Depletion

Kind of property:

Buildings: Original cost, plus additions and improvements, $449,268.89, rate 3.03, depreciation $13,548.16.

Machinery: Original cost, plus additions and improvements, $544,928.04, rate 2-4-5-6-7-8, depreciation $27,601.92.

Delivery equipment: Original cost, plus additions and improvements $6,205.00, rate 10 and 20, depreciation $1,022.00.

Tools, Furniture and Fixtures $11,161.58. Depreciation $518.15. Total, $42,690.23.

March 12, 1925.

Harald B. Rees, President. E. F. Gordon, Ass't. Treas.

[fol. 24] EXHIBIT E TO PETITION

Hans Rees' Sons, Inc., New York, N. Y.

Asset and Liability Statement

Assets, Dec. 31, 1924

Cash on hand	$121,829.29
Book accounts—good	312,519.71
Bills receivable	1,282.70
Due from employees	300.00
Insurance paid in advance	1,500.00
Interest paid in advance	0.00
Accounting paid in advance	0.00
Stock and bonds	24,500.00
Merchandise stock in New York	213,337.15
Merchandise stock elsewhere	181,672.26
Hides, leather in process, bark, supplies, etc., at tannery	554,343.43
Bark lands	40,913.13
Real estate at Asheville	40,000.00
Buildings and machinery at Asheville	994,196.93
Delivery equipment at Asheville	6,205.00
Tools, furniture and office improvements, N. Y.	25,803.88
Good will	100,000.00
	$2,618,403.48

Liabilities

Bills payable	$0.00
Accounts payable	7,948.50
Investment loans	88,105.97
Rent account	791.66
	$96,846.13
Reserve for accounts receivable	0.00
Reserve for discounts	10,887.37
[fol. 25] Reserve for depreciation	264,361.17
Reserve for employers' liability	20,229.09
Reserve for insurance	4,152.17
Reserve for Federal taxes	30,000.00
Capital stock	1,000,000.00
Surplus	* 1,191,927.55
	$2,618,403.48
Quick assets, net over liabilities	$1,273,551.04

EXHIBIT F TO PETITION

Hans Rees' Sons, Inc., New York, N. Y.

Asset and Liability Statement

Assets, Dec. 31, 1924

Cash on hand	$121,829.29
Book accounts—good	312,519.71
Bills receivable	1,282.70
Due from employees	300.00
Insurance paid in advance	1,500.00
Interest paid in advance	0.00
Accounting paid in advance	0.00

---

*$548,687.18 of this amount comes from increase in book values of buildings and machinery at Asheville as of December 31, 1924, to agree with appraisal as of December 31, 1923, made by the American Appraisal Company.

Stock and bonds	24,500.00
Merchandise stock in New York	213,337.15
Merchandise stock elsewhere	181,672.26
Hides, leather in process, bark, supplies, etc., at tannery	554,343.43
Bark lands	40,913.13
Real estate at Asheville	40,000.00
[fol. 26] Building and machinery at Asheville	997,183.95
Delivery equipment at Asheville	6,205.00
Tools, furniture and office improvements, N. Y.	25,803.88
Good will	100,000.00
	$2,621,390.50

Liabilities

Bills payable	$0.00
Accounts payable	7,948.50
Investment loans	88,105.97
Rent account	791.66
	$96,846.13
Reserve for accounts receivable	0.00
Reserve for discounts	10,887.37
Reserve for depreciation	264,361.17
Reserve for employer's liability	20,229.09
Reserve for insurance	4,152.17
Reserve for Federal taxes	30,000.00
Capital stock	1,000,000.00
Surplus	* 1,194,914.57
	$2,621,390.50
Quick assets, net over liabilities	$1,273,551.04

* $551,674,20 of this amount comes from increase in book values of buildings and machinery at Asheville, in accordance with appraisal as of December 31, 1923, made by the American Appraisal Company.

[fol. 27] EXHIBIT G TO PETITION

North Carolina State Department of Revenue

Foreign Corporation Income Tax Returns for Calendar Year Ending December 31, 1925

Hans Rees' Sons, Inc., 39 Frankfort St., New York, N.Y.
Organized 1901. Tanning and Selling Leather

Gross Income

1. Gross sales from trading or manufacturing, less return and allowances			$2,286,731.86
Less costs of goods sold:			
(a) Inventory at beginning of year	$857,539.78		
(b) Merchandise bought for sale	1,257,132.77		
(c) Cost of mfg. or otherwise producing goods	648,532.60		
(d) Total of lines a, b, c	2,763,205.15		
(e) Less inventory at end of year	917,048.52		
		1,846,156.63	
2. Gross profit from trading or manufacturing (Items 1, less cost of goods sold)			440,575.23
3. Gross income from operations other than trading or manufacturing: None.			

4. Taxable interest received from all sources: None.
5. Rentals: None.
6. Royalties: None.
7. Income from sale of capital assets: None.
8. Income received from partnership: None.

[fol. 28] 9. Total dividends received from corporations, no part of which corporation's income is subject to tax under the State law. Attach statement showing names of corporations and amount received from each.

10. Total dividends received from corporations, part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each.
11. Gross income from all other sources subject to tax.
12. Total income, 3 to 11 inclusive.

13. Total gross income, 1 to 12	440,575.23
14. Total deduction (Item 11, page 2)	301,531.80
15. Net income (total)	139,043.43
16. Net income taxable in N. C. on basis percentage of property or receipts in this State as shown on page 2	86,332.06
17. Tax due, 4 per cent of item 16	3,453.28

Page 2—Deductions

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business	153,663.13
2. Reasonable compensation of officers	56,452.49
3. Rentals or other payments required to be made as a condition of the continued use or possession, for the pur-	

pose of the trade or property to which the taxpayer has not taken, or is not taking title, or in which he has no equity 7,878.46

4. All interest paid during the income year on indebtedness, except interest on obligations contracted for the purpose of non-taxable securities. Dividends on preferred stock shall not be deducted as interest 5,873.43

[fol. 29] 5. Taxes for the income year, except taxes on income and war profits and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed 35,545.94

6. Dividends from stock in any corporation the income from which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted.

7. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

8. Loss from sale of capital assets.

9. Debts ascertained to be worthless and charged off within the taxable year if the amount has previously been included in gross income in a return under this act.

10. A reasonable allowance for depreciation and obsolescence 42,718.35

Total deductions $301,531.80

Show Below

Total fair cash value of real estate and tangible property in and out of the State on the date of the close of the taxable year	$2,293,929.85
Total fair cash value of real estate and tangible personal property in this State on date of the close of the taxable year	1,424,312.65
Percentage of property in this State	62.09%
[fol. 20] Total gross receipts in and out of the State for the year ended on the date of the close of the taxable year.	
Total gross receipts in the State for the year ended on the date of the close of the taxable year.	
Percentage of receipts in this State.	
State amount income reported or to be reported to Federal Government for year covered by this report	141,339.53

Schedule of Depreciation and Depletion No. 10

Kind of property:

Buildings: Original cost, plus additions and improvements $473,594.50, rate 2.03, depreciation $13,472.61.

Machinery: Original cost, plus additions and improvements $558,394.41, rate 2-4-5-6-7-8%, depreciation $27,823.74.

Auto trucks: Original cost, plus additions and improvements $6,205.00, rate 10 and 20, depreciation $1,022.00. Total, $42,318.35.

Harald B. Rees, President.
E. F. Gordon, Treasurer.

March 12, 1926.

Hans Rees' Sons, Schedules

Item 5—Deductions

Taxes

Asheville, N. C., privilege tax	$150.00
Asheville, N. C., city tax	10,969.47
Buncombe County	7,149.30
North Carolina franchise	902.69
Income	5,221.90
Bark lands, County taxes	1,534.07
N. Y. franchise taxes for 2 years and added amounts 1918 and 1919	7,533.51
Federal capital stock tax	2,085.00
	$35,545.94

[fol. 31] **Balance Sheet**

Assets

	Jan. 1, 1925	Dec. 31, 1925
Cash on hand	$121,829.29	$81,237.15
Book accounts (good)	312,519.71	361,521.90
Bills receivable	1,282.70	0.00
Due from employees	300.00	300.00
Insurance paid in advance	1,500.00	1,500.00
Stocks and bonds	24,500.00	24,500.00
Merchandise stock in N. Y.	213,337.15	220,804.11
Merchandise stock elsewhere	181,672.20	184,170.38
Hides, leather in process, bark, supplies, etc., Asheville	554,343.43	599,550.29
Bark lands	40,913.13	40,913.13
Real estate at Asheville	40,000.00	40,000.00
Buildings and machinery at Asheville	997,183.95	1,031,968.91
Delivery equipment at Asheville	6,205.00	6,205.00
Tools, furniture and fixtures and office Imprs. in N. Y.	25,803.88	23,465.31
Good will	100,000.00	100,000.00
	$2,621,390.50	$2,716,056.58

Liabilities

Bills payable	$0.00	$0.00
Accounts payable	7,948.50	9,718.37
Investment loans	88,105.97	97,510.68
Rent account	791.66	791.66
Reserve for discount	10,887.37	12,667.21
Reserve for depreciation	264,361.17	306,679.52
Reserve for employers' liability insurance	20,229.09	21,893.60
Reserve for insurance	4,152.17	7,249.67
Reserve for Federal taxes	30,000.00	20,000.00
[fol. 32] Capital stock	1,000,000.00	1,000,000.00
Surplus	1,194,914.57	1,239,545.87
	$2,621,390.50	$2,716,056.58

Exhibit H to Petition

Hans Rees' Sons, Inc., New York, N. Y.

Asset and Liability Statement

Assets, Dec. 31, 1925

Cash on hand	$81,237.55
Book accounts (good)	361,421.90
Bills receivable	0.00
Due from employees	300.00
Insurance paid in advance	1,500.00
Stocks and bonds	24,500.00
Merchandise stock in N. Y.	220,804.11
Merchandise stock elsewhere	184,170.38
Hides, leather in process, bark, supplies, etc., at tannery	599,550.29
Bark lands	40,913.13
Real estate at Asheville	40,000.00
Buildings and machinery at Asheville	1,031,988.91
Delivery equipment at Asheville	6,205.00
Tools, furniture and fixtures and office imprs. in N. Y.	23,465.31
Good will	100,000.00
	$2,716,056.58

Liabilities

Bills payable	$0.00
Accounts payable	9,718.37
Investment loans	97,510.68
Rent account	791.66
	$108,020.71
[fol. 33] Reserve for discounts	12,667.21
Reserve for depreciation	306,679.52
Reserve for employers' liability insurance	21,893.60
Reserve for insurance	7,249.67
Reserve for Federal taxes	20,000.00
Capital stock	1,000,000.00
Surplus	1,239,545.87
	$2,716,056.58
Quick assets—net over liabilities	$1,332,796.31

Exhibit J to Petition

Hans Rees' Sons, Inc., New York, N. Y.

Asset and Liability Statement

Assets, Dec. 31, 1926

Cash	$161,861.31
Notes receivable ($117.37 past due)	20,117.37
Customers' accounts—less reserve for doubtful 1926, $10,000.00, and discounts, 1926, $11,183.48; 1925, $12,667.21	237,338.32
Sundry accounts receivable and loans	4,003.80
Accrued interest on notes receivable	1,000.00
Inventories, as taken and priced by company	1,001,340.08
Total current assets	$1,425,660.88
Due from Hans Rees' Sons Company	$76,474.02
Tanners Products Company Stock, 140 shares at cost	17,200.00
Hans Rees' Sons Company Stock, 100 shares at par	10,000.00
Lands, buildings and equipment	1,161,825.44
Less reserves for depreciation	350,489.70
[fol. 34] Net book value	811,335.74
Good will	100,000.00
Insurance premiums, unexpired portion	7,371.00
Total	$2,448,041.64

Liabilities

Trade creditors	$544.43
Officers, employees, etc.—balances on deposit	97,257.23
Accrued wages and rent	6,018.55
Federal income tax—estimated	15,000.00
Total current liabilities	$118,820.21
Reserve for employers' liability insurance	$20,853.52

Capital stock and surplus:	
Capital stock—shares of $100.00 each	1,000,000.00
Surplus arising from appreciation of property	505,473.27
Surplus (earned)	802,894.64
Total capital stock and surplus	$2,308,367.91
Total	$2,448,041.64

EXHIBIT I TO PETITION

Copy

North Carolina State Department of Revenue

Foreign Corporation Income Tax Return for Calendar Year Ending December 31, 1926

Hans Rees' Sons, Inc., 39 Frankfort St., New York, New York

Gross Income

1. Gross sales from trading or manufacturing, less returns and allowances		$2,309,070.15
Less cost of goods sold:		
(a) Inventory at beginning of year	$1,004,524.78	
[fol. 35] (b) Merchandise bought for sale	4,456.87	
(c) Cost of manufacturing or otherwise producing goods	$1,935,968.25	
(d) Total of lines a, b, and c	2,944,949.90	
(e) Less inventory at end of year	1,001,340.08	
		1,943,609.82

2. Gross profit from trading or manufacturing (Item 1, less cost of goods sold)		365,460.33
3. Gross income from operations other than trading or manufacturing: None.		
4. Taxable interest received from all sources	$1,796.63	
5. Rentals: None.		
6. Royalties: None.		
7. Income from sale of capital assets (See Schedule, page 2)	10,515.27	
8. Income received from partnership: None.		
9. Total dividends received from North Carolina corporations. Attach statement, showing names of corporations and amount received from each: None.		
10. Total dividends received from other than North Carolina corporations. Attach statement showing names of corporations and amount received from each. (See Schedule A attached)	840.00	
11. Gross income from all other sources subject to tax	$10,718.07	
[fol. 36] 12. Total income, 3 to 11 inclusive		23,869.97
13. Total gross income, 1 to 12		389,330.30
14. Total deduction (Item 11, page 2)		282,602.75
15. Total net income		106,727.55
16. Net income taxable in North Carolina on basis percentage of property or receipts in this State as shown on page 2		91,286.49
17. Tax due, 4 per cent. of Item 16		3,651.46

Deductions

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business. See Schedule B attached	$131,590.35
2. Reasonable compensation of officers	59,177.80
3. Rentals or other payments required to be made as a condition of the continued use or possession for the purpose of the trade or property to which the taxpayer has not taken, or is not taking title, or in which he has no equity	4,750.00
4. All interest paid during the income year on indebtedness, except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest. (Attach schedule of amount and to whom paid)	6,331.52
5. Taxes for the income year, except taxes on income and war profits and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed. See schedule C attached	31,478.49
6. Dividends from stock in any other corporation. Attach statement of such dividends: None.	
[fol. 37] 7. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit (Attach schedule.): None.	
8. Loss from sale of capital assets (See schedule): None.	
9. Debts ascertained to be worthless and charged off within the taxable year if the amount has previously been included in gross income in a return under this act. (Attach schedule)	2,535.94

10. A reasonable allowance for depreciation and obsolescence (if any). See Schedule D attached	46,738.65
11. Total deductions. List opposite Item 14, page 1	$282,602.75

Schedule of Gain or Loss from Sale of Capital Assets No. 8

Kind of property: Real estate. Cost, or value Jan. 1, 1921, if owned prior to that date *$17,927.48, selling price $28,442.75, gain $10,515,27.

Show Below

Total fair cash value of real estate and tangible personal property in and out of the State on the date of the close of the taxable year	$1,812,675.82
[fol. 38] Total fair cash value of real estate and tangible personal property in this State on date of the close of the taxable year. Section 201, Chapter 101, Public Laws, 1925	1,550,422.67
Percentage of property in this State	85.53226%
Total gross receipts in and out of the State for the year ended on the date of the close of the taxable year.	
Total gross receipts in the State for the year ended on the date of the close of the taxable year.	
Percentage of receipts in this State, Section 201, Chapter 101, Public Laws, 1925.	
State amount income reported or to be reported to Federal Government for year covered by this report	112,722.53

*This property was acquired in 1912. Its appraised value in 1925 was $27,887.19. The value at January 1, 1921, has been determined by prorating the appraised value on the basis of the number of years from the date of acquisition to January 1, 1921, to the number of years from the date of acquisition to the year in which this appraised value was determined, i. e., 9/14 x $27,887.19 = $17,927.48. Gain, $10,515.27.

Schedule of Depreciation and Depletion No. 10

Kind of Property. Original Cost, Plus Additions and Improvement. Rate. Depreciation.

See Schedule D attached.

Balance Sheets

(Attach balance-sheets as of beginning and end of period for which return is filed.)

See Schedule E attached.

We, the undersigned president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1925 and the regulations issued under authority thereof.

Sworn to and subscribed before me, this — day of April, 1927. —— ——.

(Signed) H. B. Rees, President. E. F. Gordon, Treasurer.

[fol. 39] Hans Rees' Sons, Incorporated

Protest

This return is filed and the tax shown thereon is paid under protest and duress and solely to avoid the penalties provided in the law. Hans Rees' Sons, Incoirporated, contend that the apportionment of income to North Carolina is excessive, incorrect, and illegal; and they hereby reserve the right to contest the legality of the tax shown on the within report.

Hans Rees' Sons, Incorporated, by —— ——.

Schedule A

Hans Rees' Sons, Incorporated

Dividends Received from Other Than North Carolina Corporations, Calendar Year 1926

Name of corporation	Amt. received
Tanners' Products Company	$840.00

Schedule B

Hans Rees' Sons, Incorporated

Ordinary and Necessary Expenses, Calendar Year 1926

Salaries	$25,335.00
Pensions	3,000.00
Repairs	40,766.11
Payments on account of accidents to employes	6,040.08
Traveling	4,500.40
Advertising	4,764.05
Professional services	15,962.46
Insurance	4,311.02
Loss on sale of chestnut wood	7,427.41
Telephone and telegraph	5,104.22
Dues and subscriptions	1,975.05
Land maintenance	1,826.66
Patent expense	967.00
[fol. 40] Stationery, etc.	1,786.43
Adjustment, customers	336.00
Interest on additional assessment of Federal income tax for calendar year 1923	306.05
Directors' fees	100.00
Light and heat	691.54
Shipping supplies	410.57
Cost of replacing boiler	548.18
Railroad tickets	163.13
Collection and exchange	197.04
Analysis	61.50
Commission	79.20
Accounts payable, debit balances—written off	95.47
Miscellaneous	4,835.78
Total	$131,590.35

Schedule C

Hans Rees' Sons, Incorporated

Taxes Paid Calendar Year 1926

New York State franchise	$1,530.99
City—Asheville, North Carolina	11,107.56
County—North Carolina	9,501.56
Foreign corporation income—North Carolina, including additional taxes for prior years	7,558.81
Foreign corporation franchise—North Carolina	902.69
City franchise—Asheville, North Carolina	150.00
Water—Asheville, North Carolina	726.88
Total	$31,478.49

[fol. 41]

Schedule D

Hans Rees' Sons, Incorporated

Depreciation (Resulting from Exhaustion, Wear and Tear, or Obsolescence), Calendar Year 1926

Buildings: Book value, as adjusted, December 31, 1925, $469,898.13; additions during year, $7,847.27; book value, as adjusted, December 31, 1926, $477,745.40; rate of depreciation (see note), A 3%; amount of depreciation, $14,201.15.

Machinery and equipment: Book value, as adjusted, December 31, 1925, $562,090.78; additions during year, $24,531.79; book value, as adjusted, December 31, 1926, $586,622.57; rate of depreciation (see note), A 5%; amount of depreciation, $28,585.21.

Tools, fixtures, and office furniture: Book value, as adjusted, December 31, 1925, $11,751.47; additions during year, $895.00; book value, as adjusted, December 31, 1926, $12,646.47.

Delivery equipment: Book value, as adjusted, December 31, 1925, $6,205.00; Book value, as adjusted, December 31, 1926, $6,205.00; rate of depreciation (see note) A 16½%; amount of depreciation, $1,023.82.

Office improvements made under lease: Book value, as adjusted, December 31, 1925, $11,713.84; additions during year, $2,928.47; book value, as adjusted, December 31, 1926,

$8,785.37; rate of depreciation (see note), C 10 years; amount of depreciation, $2,928.47.

Total: Book value as adjusted, December 31, 1925, $1,061,659.22; additions during year, $30,345.59; book value, as adjusted, December 31, 1926, $1,092,004.81; amount of depreciation, $46,738.65.

A. Depreciation computed on the average of the book value of the assets at the beginning and end of the calendar year, exclusive of the book value of certain assets at the beginning of the calendar year.

[fol. 42] C. The deduction for amortization has been determined by amortizing the book value at December 31, 1922, over the remaining period of the lease: Book value, December 31, 1922, $20,499.25. Number of years of lease from December 31, 1922, 7 years. Amount of annual amortization (1/7 x $20,499.25), $2,928.47.

Schedule E

Hans Rees' Sons, Incorporated

Balance Sheets December 31, 1925 and 1926

Assets	December 31 1925	1926
Current Assets:		
Cash	$81,237.55	$161,861.31
Notes receivable	0.00	20,117.37
Accounts receivable:		
Customers	298,998.42	258,521.80
Due from Hans Rees' Sons Co.	62,115.31	76,474.02
Sundry	608.17	4,003.80
Accrued interest, notes receivable	0.00	1,000.00
Inventories	*1,004,524.78	1,001,340.08
Total current assets	$1,447,484.23	$1,523,318.38
Investments—Stock of domestic corporations	24,500.00	27,200.00

*Inventory at December 31, 1925, per return filed for calendar year 1925, statement of gross income, Item 1-e $917,048.52
Add inventory of supplies absorbed herein in cost of manufacturing 87,476.26
Inventory at December 31, 1925, Item 1-a, face page of this return 1,004,524.78

	December 31	
	1925	1926
Capital assets:		
Land	[illegible]	[illegible]
Buildings	[illegible]	[illegible]
Machinery and equipment	[illegible]	[illegible]
Tools, fixtures, and office furniture	11,751.47	12,646.47
[fol. 43] Delivery equipment	6,205.00	6,205.00
Office improvements made under lease	11,713.84	8,785.27
Total capital assets	$1,142,572.35	$1,161,825.44
Deferred charge—unexpired insurance	1,500.00	7,371.00
Good will	100,000.00	100,000.00
Total	$2,716,056.58	$2,819,714.82
Liabilities		
Current Liabilities:		
Accounts payable	$9,718.37	$544.42
Due to officers and employees	97,310.00	97,257.21
Accrued rent and wages	791.66	6,018.58
Total current liabilities	$108,020.71	103,820.21
Reserves:		
Depreciation of capital assets	305,079.52	350,489.70
Federal income tax	20,000.00	15,000.00
Employer' liability	21,803.60	20,853.52
Insurance	7,249.67	0.00
[fol. 44] Bad debts	0.00	10,000.00
Discounts	12,057.21	11,183.48
Total reserves	$368,490.00	$407,526.70
Capital stock	$1,000,000.00	$1,000,000.00
Surplus, including that arising from appreciation of property	$1,239,545.87	$1,308,367.91
Total	$2,716,056.58	$2,819,714.82

Before Commissioner of Revenue

In the Matter of Application of Hans Rees' Sons, Inc., for the Revision of Income Taxes Assessed Against It by the State of North Carolina in the Years 1923, 1924, 1925, and 1926

Petitioner's Request for Findings of Fact and Conclusions of Law—Filed Dec. 17, 1927

To the Commissioner of Revenue of the State of North Carolina:

The undersigned petitioner respectfully requests that you make the following Findings of Fact and Conclusions of Law in the above-entitled matter:

Findings of Fact

1. That petitioner, Hans Rees' Sons, Incorporated, is a corporation organized and existing under and by virtue of

the laws of the State of New York and having its principal office and place of business in New York City, and is duly authorized to do business in the State of North Carolina, and brings this proceeding in accordance with Sections 340 and 341 of Chapter 80 of the Public Laws of 1907 of the State of North Carolina.

[fol. 45] 2. That in accordance with Section 400, Chapter 4, of the Public Laws of 1923 of North Carolina, and amendments thereto, the petitioner, on or about the 11th day of March, 1924, duly filed with the Commissioner of Revenue of North Carolina, a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of the petitioner for the calendar year of 1923 to be $230,279.40. Said report also showed the nature of the petitioner's business and the location and amount of its assets, a copy of said report being attached to the petition in this cause and marked "Exhibit A." In said report the petitioner allocated all of its property, except its good-will, between North Carolina and property wherever located, and, as appeared from said report, 57.32% of its assets were allocated as located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina (as having its source in North Carolina), on the theory that the income could fairly be apportioned in proportion to location of assets, gave North Carolina income of $131,996.15. Thereafter a tax of 3% upon said apportioned net income was assessed against the petitioner amounting to $3,959.88, which tax the petitioner duly paid on the 11th day of March, 1924, to the Commissioner of Revenue, at Raleigh, North Carolina, the officer duly designated to collect said taxes in accordance with Section 500 of Chapter 4 of the Public Laws of 1923 of North Carolina, and amendments thereto.

Thereafter the said Commissioner re-examined and audited said return and found the total net income shown therein to be correct, except the debts amounting to $2,552.50 reclaimed, but not included in the original report, were added by the Commissioner, and dividends amounting to $904 were deducted, making a final corrected net income of $231,927.90. But the Commissioner held that the apportionment of the net income to North Carolina should

be in proportion to the location of physical assets, and, disregarding the location of accounts receivable, money in [fol. 46] banks, and all other assets, except tangible physical properties, he allocated to North Carolina 83.7% of said physical properties, and applying this percentage as the allocation of income apportioned to North Carolina as income having its source in said State, gave to North Carolina 83.7% of the total net income for the year 1923, or the sum of $194,123.65.

The Commissioner of Revenue accordingly assessed the tax against the petitioner of 3% on $194,123.65, said apportioned net income, amounting to $5,823.61, and crediting against said tax the $3,959.88 paid on the 11th day of March, 1924, demanded payment of $1,863.73, additional income tax for 1923, with additional interest thereon of $260.92, or a total additional payment of $2,124.65.

Thereafter, on or about the 13th day of August, 1926, the petitioner paid said additional tax, but under duress and compulsion and upon the express protest that said additional tax was illegal and void, and that the petitioner should not be compelled to pay the same, and reserved the right to contest the legality of said tax in subsequent proceedings to be taken in accordance with law.

3. That in accordance with Section 400 of Chapter 4 of the Public Laws of 1923 of North Carolina, and amendments thereto, the petitioner, on or about the 14th day of March, 1925, duly filed with the Commissioner of Revenue of North Carolina, a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of the petitioner for the calendar year 1924 to be $253,921.82. Said report also showed the nature of the petitioner's business and the location and amount of its assets. A copy of said report is annexed to the petition filed in this cause and marked "Exhibit D."

In said report the petitioner allocated all of its property, except its good-will, between North Carolina and property wherever located, and as appears from said report, [fol. 47] 68.55% of its assets were allocated as located in North Carolina. Applying this percentage as an apportionment of the income allocated to North Carolina as income having its sources in North Carolina, on the theory that income could fairly be apportioned in proportion to

the location of assets, gave North Carolina income of $174,063.41.

Thereafter a tax of 3% upon said apportioned net income was assessed against the petitioner, amounting to $5,221.90, which tax the petitioner duly paid on the 14th day of March, 1925, to the Commissioner of Revenue at Raleigh, North Carolina, the officer duly designated to collect said taxes, in accordance with Section 500 of Chapter 4 of the Public Laws of 1923 of North Carolina, and amendments thereto.

Thereafter the said Commissioner re-examined and audited said return and found the total net income shown therein to be correct, except for the sum of $3,959.88 covering North Carolina income tax paid, which the Commissioner held was not deductible under the North Carolina law. This made a total corrected net income of $257,881.70, but the Commissioner held that the apportionment of the net income to North Carolina should be in proportion to the location of the physical assets, and disregarding the location of the accounts receivable, money in banks, and all other assets, except tangible physical properties, he allocated to North Carolina 85.89% of said physical properties, and applying this percentage as the allocation of income apportioned to North Carolina as income having its source in said State, 85.89% of the total income for 1924, or the sum of $221,494.59 to North Carolina. The Commissioner of Revenue accordingly assessed the tax against the petitioner of 3% of $221,494.59, said apportioned net income amounting to $6,644.84, and crediting against said tax the sum of $5,221.90 paid on the 14th of March, 1925, demanded payment of $1,422.94 additional income tax for 1924, with additional interest thereon of $113.83, or a total additional payment of $1,536.77.

[fol. 48] Thereafter, on or about the 13th day of August, 1926, the petitioner paid said additional tax, but under duress and compulsion, and upon the express protest that the said additional tax was illegal and void, and that the petitioner should not be compelled to pay the same, and reserved the right to contest the legality of said tax in subsequent proceedings to be taken in accordance with law.

4. That in accordance with Section 400 of Chapter 101 of the Public Laws of North Carolina for 1925, and amend-

ments thereto, the petitioner, on or about the 15th day of March, 1926, duly filed with the Commissioner of Revenue of North Carolina a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of the petitioner for the calendar year 1925 to be $139,043.43. Said report also showed the nature of the petitioner's business and the location and amount of its assets. A copy of said report is annexed to the petition filed in this cause and marked "Exhibit G." In said report the petitioner allocated all of its property, except its good-will, between North Carolina and property wherever located, and as appears from said report, 62.09% of its assets were allocated as located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina as income having its source in North Carolina, on the theory that income could fairly be apportioned in proportion to location of assets, gave North Carolina income of $86,332.06.

Thereafter a tax of 4% upon said apportioned net income was assessed against the petitioner amounting to $3,453.28, which tax the petitioner duly paid on the 15th day of March, 1926, to the Commissioner of Revenue at Raleigh, North Carolina, the officer duly designated to collect said tax, in accordance with Section 500 of Chapter 101 of Public Laws of 1925 for North Carolina and amendments thereto.

Thereafter the Commissioner re-examined and audited said return and increased the total net income shown from [fol. 49] $139,043.43 to $141,339.53, by adding $1,111.49 for freight and $1,084.61 for bad debts collected, but not included in the petitioner's report, and $100 to cover a mathematical error in the original report, or a total of $2,296.10. To this net income of $141,339.53 the Commissioner added $5,221.90 to cover North Carolina income taxes which had been deducted in petitioner's report, but which the Commissioner held were not deductible under the North Carolina statute. The Commissioner also held that the apportionment of the net income to North Carolina should be in proportion to the location of physical assets and reduced the whole value of petitioner's property, for the purpose of allocation, from $2,293,929.85 to $2,147,097.13, although the value of all the petitioner's physical assets was only $1,840,417.61, and disregarding the location of accounts receiv-

able, money in banks, and all other assets, except tangible physical properties, he allocated to North Carolina 66.32% of said physical properties, and applying this perecentage as the allocation of income apportioned to North Carolina as income having its source in said State, gave to North Carolina 66.32% of the total income for 1925, or a total of $97,217.13.

The Commissioner of Revenue accordingly assessed the tax against the petitioner of 4% on $97,217.13, said apportioned net income amounting to $3,888.68, and crediting against said tax $3,453.28 paid on the 15th day of March, 1926, demanded payment of $435.40, additional income tax for 1925, with additional interest thereon of $8.71, or a total additional payment of $444.11.

Thereafter, and on or about the 13th day of August, 1926, the petitioner paid said additional tax, but under duress and compulsion, and upon the express protest that the said additional tax was illegal and void, and that the petitioner should not be compelled to pay the same, and reserved the right to contest the legality of said tax in subsequent proceedings to be taken in accordance with law.

[fol. 50] 5. That in accordance with the provisions of Chapter 101 of the Public Laws of 1925 of North Carolina, the petitioner, on or about the 11th day of April, 1927, after having obtained from the Commissioner of Revenue of North Carolina an extension of time for the filing of said report until April 15, 1927, duly filed with the Commissioner of Revenue of North Carolina a report on the form prescribed by the Department of Revenue of North Carolina, which report showed the total net income of the petitioner for the calendar year of 1926 to be $106,727.55. Said report also showed the nature of the petitioner's business and the location and amount of its assets. A copy of said report is attached to the petition and marked "Exhibit I." In said report the petitioner apportioned its net income in North Carolina in proportion to the location of its physical assets, disregarding the location of accounts receivable, money in banks, and all other assets, except tangible physical properties, as was required by the Commissioner of Revenue of North Carolina in connection with the 1923, 1924, and 1925 taxes, as stated in the preceding findings of fact herein; and upon that basis allocated to North Carolina

85.53226% of its total income of $106,727.55, or a total net income apportioned to North Carolina of $91,286.48. A tax was accordingly assessed against the petitioner of 4% on $91,286.48, said apportioned net income, or a total of $3,651.46, which the petitioner paid upon express protest that said tax was illegal and void and the petitioner was compelled to pay the same under duress and compulsion, and reserved the right to contest the legality of said tax in subsequent proceedings to be taken in accordance with law.

Said tax was thus paid under protest on the 11th day of April, 1927, after the petitioner had obtained an extension of time for the payment thereof from the Commissioner of Revenue of North Carolina, to the Commissioner of Revenue of North Carolina, the officer designated in Chapter 101 of the Laws of 1925 to collect the said tax.

[fol. 51] 6. That the copies of the petitioner's tax returns for the years 1923, 1924, 1925, and 1926, attached to the petition filed in this cause and marked "Exhibit A, Exhibit D, Exhibit G, and Exhibit I," respectively, are true and correct copies of the originals which were filed with the Commissioner of Revenue of North Carolina.

7. That the petitioner is engaged in the business of buying hides, tanning the hides into leather, and selling the leather to customers throughout the United States. It owns a tannery and appurtenances at Asheville, North Carolina, where it performs substantially all of its manufacturing operations. It also owns certain bark lands in North Carolina which are held as reserve supply of raw material, but during none of the years in question has it cut any bark on any of these lands which it owns, nor used any of the produce of said lands in its business.

8. That only a negligible amount of its hides, or other raw materials, is purchased in North Carolina. Substantially all of its hides are purchased in Chicago, Illinois, and are shipped from Chicago to Asheville, North Carolina. Its sales are practically none of them made from North Carolina and are substantially all made from petitioner's head office in New York City. Those sales which are not made from New York are made by salesmen who travel in its behalf throughout the different States of the United States, and practically all of its sales are made in interstate com-

merce by shipments to customers throughout the United States.

9. That a portion of the leather, when tanned at its Asheville tannery and ready for sale, is shipped to the petitioner's store in New York City and is then sold from its New York store to customers. The largest part of its sales are shipped by petitioner direct from the tannery in Asheville to customers throughout the United States, practically all of whom are outside of North Carolina. That the orders for such sales are received in the New York office of the [fol. 52] petitioner, and instructions are sent from the New York office to the tannery at Asheville to ship a stipulated quantity of leather to a stipulated customer at a stipulated address. Bills for the sales so made are sent to the customer from the petitioner's New York office, and all remittances are made to the petitioner's New York office.

10. That all of the petitioner's banking and other business is done in New York City, with the exception of small bank accounts which are carried in Asheville for the purpose of paying the pay-rolls and other manufacturing bills.

11. The petitioner's net income is derived from a continuous business consisting of buying the hides and other raw materials outside the State of North Carolina, shipping these materials to its tannery at Asheville, manufacturing the hides into leather in the State of North Carolina, and selling the leather outside the State of North Carolina. The net income from the petitioner's business is not separated on its books so as to show separately a manufacturing profit and a selling profit, the entire profit appearing from the sale of the goods.

12. That the leather which is made from the hide is of a different quality and a different value from different parts of the hide. The hide is bought at a flat average price per pound and is tanned in a single piece, after which the tanned hide is cut up. The back, sides, and shoulders are better and of more valuable quality of leather, and are sold for belting and other similar purposes. The bellies and heads are of inferior quality of leather, and are sold at a lower price in another market. That most of the large tanners of the country sell the back, sides, and shoulders as a single piece, which is called a butt. The bellies and heads are sold sepa-

rately to another market. The petitioner sells its bellies and heads in the same way that other tanners sell them, but it makes little money on its sales of bellies and heads. The petitioner does not sell its butts, as do most of the other large tanners of the country, as a single piece. The trade of the petitioner is largely to small manufacturers; and [fol. 53] instead of selling an entire butt to them, the petitioner cuts the butt up and finishes it to meet the particular requirements of the individual customers; and for these smaller pieces of leather so cut and and sold, the petitioner receives a much higher price than the prevailing market price for entire butts. Substantially all of the profit made by the petitioner is derived from the manipulation of the butt and selling it in such a way that the petitioner receives a larger price than the prevailing market price for butts.

13. The cost of buying the hides and tanning the leather at the petitioner's plant is such that the cost of the butts frequently exceeds the market selling price of butts tanned at other tanneries. From time to time the petitioner buys butts, which it finishes, cuts up, and sells to its customers; and in such case the profit per pound on the resale of the leather purchased is usually more than the profit per pound on the leather tanned at the same time in the petitioner's own factory. In the year 1919, when the petitioner bought these butts quite extensively, it made a profit on the sale of leather cut up from these butts of 22.26 cents a pound; while in the same year its profit on leather cut from butts which it had tanned in its own factory was only 13.57 cents a pound.

14. That many tanners, either because of the insufficient capital or for other reasons, do not purchase hides and tan them for their own account, but enter into tanning contracts with packers or others who kill cattle and own the hides. Under these tanning contracts the tanners are paid a fixed price per pound for tanning hides into leather, and the leather belongs to the packer or the owner of the hide. During the year 1926 the price of such tanning contracts ranged from 11 cents to 13 cents a pound, with an average price of about 12 cents. During the year 1925 the price of such tanning contracts ranged from 11 cents to 12 cents a pound, with an average price of about 12 cents. During the year 1924 there were very few tanning contracts made,

so that no average price is available. During the year 1923 [fol. 54] the price of such tanning contracts ranged from 14 cents to 15 cents a pound, with an average price of about 14½ cents. That petitioner could have had its hides tanned for it by others on one of these tanning contracts, so that the profit or loss of petitioner from its tanning operations may be computed by multiplying the pounds of leather it tanned by the difference between the actual tanning cost per pound and the cost per pound which it would have had under one of these tanning contracts.

15. That the difference between selling entire butts and cutting the butt up and selling it in pieces, as the petitioner does, is substantially the difference between a wholesale and a retail business.

16. That the process of converting green hides into marketable leather takes several months. The price of hides fluctuates quite widely and often suddenly. On the other hand, the price of leather fluctuates much more slowly, and usually does not reflect the smaller fluctuations in the price of hides. The profit or loss in the tanning business is therefore largely dependent on the skill with which the tanner buys his hides, and it may be approximately measured by the difference between the average market prices of hides and the actual cost of hides to the individual tanner. In petitioner's case the hides are substantially all purchased outside of the State of North Carolina, and have been bought with such skill that the cost of its hides in the years in question has usually been substantially less than the average price of similar hides in the respective years.

17. That during the year 1926 the average market price of bellies was 27 cents a pound, and the average price received by petitioner in 1926 for bellies was 26.48 cents a pound. In the same year the average market price of heads was 16 cents a pound, and the average price received by the petitioner was 14.61 cents a pound.

[fol. 55] 18. That during the year 1925 the average market price for bellies was 24½ cents a pound, and the average price received by petitioner in 1925 for bellies was 23 cents a pound. In the same year the average market price of heads was 15 cents a pound, while the average price received by petitioner was 12 cents a pound.

19. That during the year 1924 the average market price for bellies was 20.75 cents a pound, and the average price received by petitioner in 1924 for bellies was 19.17 cents a pound. In the same year the average market price of heads was 12.5 cents a pound, while the average price received by petitioner was 9.6 cents a pound.

20. That during the year 1923 the average market price for bellies was 24 cents a pound, and the average price received by petitioner in 1923 for bellies was 19.95 cents a pound. In the same year the average market price of heads was 16 cents a pound, and the average price received by the petitioner was 10.34 cents a pound.

21. That the average market selling price of butts for the year 1926 was 55.8665 cents a pound. The petitioner received in 1926 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 67.943 cents per pounds. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1926, to 6.052 cents per pound. Allowing for the finishing cost, during the year 1926 the petitioner received an average price of 6.025 cents per pound more for the leather than it sold from the butts which it tanned than the average market price for the butts. During the year 1926 he petitioner sold 3,239,904 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $195,204.22 more than would have been received had these butts been sold as butts at the current market prices for that year. This amount of $195,204.22 exceeds the total net profits of [fol. 56] the petitioner for the year 1926, indicating that the tanning operations of the petitioner were conducted at an actual loss.

22. That the average market selling price of butts for the year 1925 was 57.666 cents per pounds. The petitioner received in 1925 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 68.45 cents per pound. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1925, to 5.455 cents per pound. Allowing for this finishing cost, during the year 1925 the petitioner re-

ceived an average price of 5.33 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During the year 1925 the petitioner sold 3,134,445 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $167,065.92 more than would have been received had these butts been sold as butts at the current market prices for that year.

23. That the average market selling price of butts for the year 1924 was 55.25 cents per pound. The petitioner received in 1924 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 68.96 cents per pound. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1924, to 4.953 cents per pound. Allowing for this finishing cost, during the year 1924 the petitioner received an average price of 8.757 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During he year 1924 the petitioner sold 2,888,785 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $252,970.90 more than would have been received had these butts been sold as butts at the current market prices for that year.

[fol. 57] 24. That the average market selling price of butts for the year 1923 was 67.521 cents per pound. The petitioner received in 1923 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 78.33 cents per pound. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1923, to 4.718 cents per pound. Allowing for this finishing cost, during the year 1923 the petitioner received an average price of 6.091 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During the year 1923 the petitioner sold 3,033,933 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $184,796.70 more than would have been received had these butts been sold as butts at the current market prices for that year.

25. That petitioner has for many years separated its accounts between its wholesale business and its retail business. The wholesale business consists chiefly of bellies and heads, which are ordinarily sold in carload lots and in the same way that most other tanners sell their product. This business is called on the petitioner's books by the arbitrary term of "Merchandise Sales." The retail part of petitioner's business is called on its books "Curried and Specialty," and this is all sold in less than carload lots.

26. For the year 1926 the petitioner's Merchandise Sales amounted to $671,800.16, with a gross profit of $35,782.30, or a gross profit on sales of 5.54%. The retail business of petitioner for the year 1926 had gross sales of $1,676,776.75, with a gross profit of $133,468.60, or 8% on sales. Had petitioner purchased butts in the open market during the year 1926 at an average cost of 55.8665 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, and sold it instead of the leather that it actually tanned, its gross [fol. 58] profits on said retail business would have been $61,735.62 greater than it actually was, or $195,204.22 as shown in Finding No. 21.

27. For the year 1925 the petitioner's Merchandise Sales amounted to $705,590.31, with a gross profit of $70,322.17, or a gross profit on sales of 9.97%. The retail business of petitioner for the year 1925 had gross sales of $1,648,112.26, with a gross profit of $251,952.70, or 15.29% on sales. Had petitioner purchased butts in the open market during the year 1925 at an average cost of 57.666 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $84,886.88 less than it actually was, or $167,065.92, as shown in Finding No. 22.

28. For the year 1924 the petitioner's Merchandise Sales amounted to $566,856.15, with a gross profit of $98,708.12, or a gross profit on sales of 17.41%. The retail business of petitioner for the year 1924 had gross sales of $1,549,188.09, with a gross profit of $304,578.55, or 19.66% on sales. Had petitioner purchased butts in the open market during the

year 1924 at an average cost of 55.25 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $51,607.65 less than it actually was, or $252,970.90 as shown in Finding No. 23.

29. For the year 1923 petitioner's Merchandise Sales amounted to $639,006.67, with a gross profit of $69,713.85, or a gross profit on sales of 10.91%. The retail business of petitioner for the year 1923 had gross sales of $1,901,930.41, with a gross profit of $330,699.95, or 17.39% on sales. Had petitioner purchased butts in the open market during the year 1923 at an average cost of 67.521 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, [fol. 59] and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $145,903.25 less than it actually was, or $184,796.70, as shown in Finding No. 24.

30. That petitioner's actual cost of tanning leather in its own tannery in 1926 was 13.84 cents per pound. During the year 1926 the petitioner tanned 5,229,637 pounds of leather. Its actual cost of tanning this leather was, therefore, $97,513.32 more than the tanning cost would have been based on the average price of tanning contracts in effect during the year.

31. That petitioner's actual cost of tanning leather in its own tannery in 1925 was 13.67 cents per pound. During the year 1925 the petitioner tanned 4,796,036 pounds of leather. Its actual cost of tanning this leather was, therefore, $80,093.80 more than the tanning cost would have been based on the average price of tanning contracts in effect that year.

32. That petitioner's actual cost of tanning leather in its own factory in 1924 was 12.97 cents per pound. During the year 1924 the petitioner tanned 4,835,888 pounds of leather. Its actual cost of tanning this leather was, therefore, $627,214.67. Because of the absence of data as to tanning contracts this year, it is impossible to show the relative tanning cost.

33. That petitioner's actual cost of tanning leather in its own factory in 1923 was 13.95 cents per pound. During the year 1923 the petitioner tanned 5,091,311 pounds of leather. Its actual cost of tanning this leather was, therefore, $28,002.21 less than the tanning cost would have been based on the average price of tanning contracts in effect that year.

34. During the year 1926 packer steer hides varied in market price from 11.5 cents to 16 cents a pound, with an average price for the year of 14 cents a pound. During this year petitioner purchased 4,491,759 pounds of packer steer hides at an actual cost of 13.42 cents a pound. Its actual cost of steer hides was, therefore, .58 cents a pound, or $26,052.20 less than it would have been had these hides been purchased at the average market price. During the same [fol. 60] year packer cow hides varied in market price from 11 cents to 14.5 cents a pound, with an average price for the year of 13 cents a pound. During the year petitioner purchased 1,302,099 pounds of packer cow hides at an actual cost of 12.58 cents a pound. Its actual cost of cow hides was, therefore, .42 cents a pound, or $5,468.81 less than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1926 was $31,521.01 greater than it would have been had its hides been purchased in regular course at average market prices.

35. During the year 1925 packer steer hides varied in market price from 14 cents to 17½ cents a pound, with an average price for the year of 16 cents a pound. During this year petitioner purchased 5,052,552 pounds of packer steer hides at an actual cost of 15.44 cents a pound. Its actual cost of steer hides was therefore .56 cents a pound, or $28,294.29 less than it would have been had these hides been purchased at the average market price. During the same year packer cow hides varied in market price from 14 cents to 16 cents a pound, with an average price for the year of 14¾ cents a pound. During the year petitioner purchased 708,551 pounds of packer cow hides at an actual cost of 14.35 cents a pound. Its actual cost of cow hides was, therefore, .4 cents a pound, or $2,834.20 less than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit

for the year 1925 was $31,128.49 greater than it would have been had its hides been purchased in regular course at average market prices.

36. During the year 1924 packer steer hides varied in market prices from 10¾ cents to 18 cents a pound, with an average price for the year of 14½ cents a pound. During this year petitioner purchased 5,782,409 pounds of packer steer hides at an actual cost of 13.14 cents a pound. Its actual cost of steer hides was, therefore, 1.36 cents a pound, or $78,640.76 less than it would have been had these hides been purchased at the average market price. During the same year [fol. 61] packer cow hides varied in market price from 9 cents to 15½ cents a pound, with an average price for the year of 12 cents a pound. During the year petitioner purchased 675,383 pounds of packer cow hides at an actual cost of 9.87 cents a pound. Its actual cost of cow hides was, therefore, 2.13 cents a pound, or $14,385.66 less than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1924 was $93,026.42 greater than it would have been had its hides been purchased in regular course at average market prices.

37. During the year 1923 packer steer hides varied in market price from 13½ cents to 20½ cents a pound, with an average price for the year of 16¾ cents a pound. During this year petitioner purchased 4,834,375 pounds of packer steer hides at an actual cost of 14.8 cents a pound. Its actual cost of steer hides was, therefore, 1.95 cents a pound, or $94,270.31, less than it would have been had these hides been purchased at the average market price. During the same year packer cow hides varied in market price from 10 cents to 16 cents a pound, with an average price for the year of 13 cents a pound. During the year petitioner purchased 1,401,746 pounds of packer cow hides at an actual cost of 15.64 cents a pound. Its actual cost of cow hides was, therefore, 2.64 cents a pound, or $37,006.09 more than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1923 was $57,264.22 greater than it would have been had its hides been purchased in regular course at average market prices.

38. That during the year 1926 the petitioner's gross sales amounted to $2,451,738.44, and its sales to customers in the State of North Carolina during that period amounted to $6,376.01.

39. That during the year 1925 the petitioner's gross sales amounted to $2,413,581.71, and its sales to customers in the State of North Carolina during that period amounted to $7,603.76.

[fol. 62] 40. That during the year 1924 the petitioner's gross sales amounted to $2,167,000.51, and its sales to customers in the State of North Carolina during that period amounted to $4,817.73.

41. That during the year 1923 the petitioner's gross sales amounted to $2,598,332.56, and its sales to customers in the State of North Carolina during that period amounted to $6,727.14.

42. That the petitioner for 1926 had total assets of $2,448,041.64, and its net profits amounted to $106,727.55, or 4.37% earned on its assets, and its total net sales amounted to $2,309,070.15, so that its profit on sales was 4.6%.

43. That the petitioner for 1925 had total assets of $2,409,377.06, and its net profit amounted to $139,043.43, of 5¾% earned on its assets, and its total net sales amounted to $2,286,731.86, so that its profit on sales was 6%.

44. That the petitioner for 1924 had total assets of $2,357,029.33, and its net profits amounted to $253,921.82, or 10.8% earned on its assets, and its total net sales amounted to $2,109,021.39, so that its profit on sales was 12%.

45. That the petitioner for 1923 had total assets of $1,693,385.10, and its net profits amounted to $230,279.40, or 12% earned on its assets, and its total net sales amounted to $2,485,867.55, so that its profits on sales was 9.2%.

46. The income of petitioner flows from three sources, to-wit: a profit on buying hides at less than market, a manufacturing profit on tanning the leather, and a selling profit largely arising from its method of selling at retail instead of wholesale. The data contained in other findings affords an approximate relative proportion of these items of profit.

In the year 1926 this method of computation indicates a buying profit of $31,521.01, a selling profit of $195,204.22, and a manufacturing loss of $61,735.62, or a total gross profit of $164,989.61. The actual gross profit was $169,- [fol. 63] 250.90, or very close to the total reached by determination of income by source. None of the income had its source in manufacture in North Carolina this year.

In the year 1925 this method of computation indicates a buying profit of $31,128.49, a tanning profit of $84,886.88, and a selling profit of $167,065.92, or a total gross profit of $283,081.29. As the actual gross profit was $322,274.87, in this year there was a profit of $39,135.59 (or about 14% of the total) not distributed on this allocation of profits. This allocation indicates that in the year 1925 about 26% of the income had its source in the manufacturing operations in the State of North Carolina.

In the year 1924 this method of computation indicates a buying profit of $93,026.42, a tanning profit of $51,607.65, and a selling profit of $252,970.90, or a total gross profit of $397,604.97. The actual gross profit was $403,286.67, or very close to the total reached by determination of income by source. This allocation indicates that in the year 1924 about 13% of the income had its source in the manufacturing operations in the State of North Carolina.

In the year 1923 this method of computation indicates a buying profit of $57,244.22, a tanning profit of $145,903.25, and a selling profit of $184,796.70, or a total gross profit of $387,944.17. The actual gross profit was $400,413.80, or very close to the total reached by determination of income by source. This allocation indicates that in the year 1923 about 37% of the income had its source in the manufacturing operations in the State of North Carolina.

For the four years in question an average of about 17% of petitioner's income was derived from the manufacturing operations of the petitioner conducted within the State of North Carolina, and that during said years 83% of petitioner's total income had its source wholly without the State of North Carolina and arose from the buying and merchandising operations of the petitioner conducted wholly without the State of North Carolina.

[fol. 64] 47. The per cent of profit on money invested in the business, and the per cent. of profit on sales of those

companies which do primarily a wholesale business, and whose profit therefore is primarily attributable to the manufacturing operations, is very much less than that of the petitioner. For example, the Central Leather Company claims to own two-thirds of the total production capacity of the entire country for heavy leather. In 1926 it had assets of $90,118,174.37, and showed net earnings for the year ending December 31, 1926, before deducting discount on bonds, of $1,494,919.58, or about 1.6% on its assets. In 1925 it had assets of $91,789,050.52; for the year ending December 31, 1925, before deducting interest, its profits were $2,548,014.59, or about 2¾% on its assets. In 1924 this company showed net earnings before deducting interest of $1,353,900.85, and after deducting interest a net loss of $484,306.65; and for the year 1923 it showed a net loss of $5,434,035.44. This company does not report its gross sales, so that it is impossible to compute the relation of profits to sales.

The National Leather Company in 1926 had total assets of $22,593,388.35. Its sales in that year amounted to $24,556,398.24. It sustained a net loss before deducting interest of $239,823.43. In 1925 it had total assets of $25,358,684.50. Its total sales in that year amounted to $25,837,340.88. Its net profit before deducting interest was $720,557.53. That is, it earned about 2.8% on its assets, and made about 2¾% on its sales. In 1924 it had total assets of $28,365,474.67. Its total sales in that year amounted to $26,520,817.81. Its net profit before deducting interest was $951,387.31. That is, it earned about 3.4% on its assets, and made about 3.6% on its sales. In 1923 it had total assets of $30,327,610. Its total sales in that year amounted to $28,441,140. Its net profit before deducting interest was $2,278,239. That is, it earned about 7½% on its assets, and made about 8% on its sales.

The Pfister & Vogel Leather Company had in 1926 assets of $15,287,816.79. Its report does not show its profits or [fol. 65] sales for 1926. In 1925 it had assets of $17,390,967.76. Its net profit before interest was $135,523.92, or only about 8/10 of 1% on its assets.

48. That the petitioner has complied with all of the provisions of law authorizing it to do business in North Carolina, and has paid all taxes assessed against it in said State;

that the income taxes complained of in said petition are not commutation taxes, or taxes levied in lieu of or to take the place of other taxes; that the petitioner has paid other taxes in North Carolina as follows:

For the year 1923 the petitioner paid the City of Asheville taxes of	$9,434.46
Asheville City franchise tax	150.00
County taxes	7,624.58
State franchise tax	622.70
Taxes upon land owned by it in Western North Carolina amounting to	1,217.48
Or a total of	$19,049.22
For the year 1924 the petitioner paid Asheville City taxes amounting to	$9,014.08
Asheville City franchise tax	150.00
County taxes	5,874.86
State franchise tax	573.20
Taxes upon land owned by it in Western North Carolina amounting to	1,264.03
Or a total of	$16,867.17
For the year 1925 the petitioner paid Asheville City taxes of	$10,969.47
Asheville City franchise tax	150.00
County taxes	7,149.30
[fol. 66] State franchise tax	902.69
Taxes on land, amounting to	1,534.07
Or a total of	$20,705.53
For the year 1926 the petitioner paid Asheville City taxes of	$11,107.56
City franchise tax	150.00
County taxes of	9,501.56
State franchise tax	902.69
Taxes upon land of	1,560.88
Or a total of	$23,222.69

49. For the year 1926 the asset side of the balance sheet of the petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York		$150,705.83
Cash on hand in Asheville		11,155.48
Notes receivable ($117.37) past due		20,117.37
Customers' accounts, less reserve for doubtful 1926, $10,000.00, and discounts, 1926, $11,183.48; 1925, $12,667.21		237,338.32
Sundry accounts receivable and loans		4,003.80
Accrued interest on notes receivable		1,000.00
Merchandise in New York and in transit		246,185.89
Merchandise in Asheville		233,194.76
Hides, leather in process, bark, supplies, etc., at tannery		521,959.43
Due from Hans Rees' Sons Company		76,474.02
Tanners Products Company stock, 140 shares at cost		17,200.00
[fol. 67] Hans Rees' Sons Company stock, 100 shares at par		10,000.00
Bark lands, North Carolina	$29,820.63	
Real estate at Asheville	40,000.00	
Buildings and Machinery at Asheville	1,064,367.97	
Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvements, New York	21,431.84	
	$1,161,825.44	
Less reserve for depreciation	350,489.70	
Net book value		811,335.74
Good-will		100,000.00
Insurance premium—unexpired portion		7,371.00
		$2,448.041.64

50. For the year 1925 the asset side of the balance sheet of petitioner, showing the assets segregated as to their lo-

cation within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York		$79,392.46
Cash on hand in Asheville, N. C.		1,845.09
Book accounts—Good		361,421.90
Bills receivable		0.00
Due from Employees		300.00
Insurance paid in advance		1,500.00
Stocks and Bonds		24,500.00
Merchandise stock in New York and in transit		243,327.01
Merchandise stock in Asheville, N. C.		161,647.48
Hides, leather in process, bark, supplies, etc. at tannery		599,550.29
Bark lands, North Carolina	$40,913.13	
[fol. 68] Real estate at Asheville	40,000.00	
Buildings and machinery at Asheville	1,031,988.91	
Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvements, New York	23,465.31	
	$1,142,572.35	
Less reserve for depreciation	306,679.52	
Net book value		835,892.83
Good-will		100,000.00
		$2,409,377.06

51. For the year 1924 the asset side of the balance sheet of the petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York	$120,677.11
Cash on hand in Asheville, N. C.	1,152.18
Book Accounts—Good	312,519.71
Bills Receivable	1,282.70
Due from Employees	300.00
Insurance paid in advance	1,500.00

Interest paid in advance		0.00
Accounting paid in advance		0.00
Stocks and Bonds		24,500.00
Merchandise stock in New York and in transit		248,145.07
Merchandise stock in Asheville, N. C.		146,864.34
Hides, leather in process, bark, supplies, etc., at tannery		554,343.43
Bark lands, North Carolina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings & Machinery, Asheville	997,183.95	
[fol. 69] Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvements, New York	25,803.88	
	$1,110,105.96	
Less reserve for depreciation	264,361.17	
Net book value		845,744.79
Good-will		100,000.00
		$2,357,029.33

52. For the year 1923 the asset side of the balance sheet of the petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York	$143,615.02
Cash on hand in Asheville, N. C.	6,879.75
Book Accounts—Good	267,090.80
Bills Receivable	0.00
Due from Employees	578.29
Insurance paid in advance	1,500.00
Interest paid in advance	307.10
Accounting paid in advance	800.00
Stocks and Bonds	24,500.00
Merchandise stock in New York and in transit	226,479.13
Merchandise stock in Asheville, N. C.	149,279.24
Hides, leather in process, bark, supplies, etc., at tannery	481,380.65

Bark lands, North Carolina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings and machinery at Asheville	433,715.69	
Delivery equipment at Asheville	5,845.32	
Tools, furniture and office improvements, New York	28,270.83	
	$548,744.97	
[fol. 70] Less reserve for depreciation	257,769.85	
Net book value		290,975.12
Good-will		100,000.00
		$1,693,385.10

53. That for each of the years here drawn in question a tax has been assessed in accordance with the laws of the State of North Carolina upon that portion of petitioner's total income that the tangible assets in the State of North Carolina bear to the total tangible assets wherever located, and that in making such apportionment no regard was had to the location of intangible assets or to the particular nature of the petitioner's business or to the actual source of petitioner's income.

54. That for each of the taxes here drawn in question, the method of appropriating petitioner's income results, in petitioner's case, in subjecting to tax by North Carolina a larger amount of income than in fact has its source in North Carolina, so that the taxes here complained of are in part assessed against income derived by this foreign corporation from sources entirely without the State of North Carolina.

Conclusions of Law

1. That the State of North Carolina cannot constitutionally levy an income tax upon that portion of the petitioner's

income that has its source outside the State of North Carolina.

2. That Section 201, Chapter 4, of the Public Laws of North Carolina, for 1923, as construed and applied to the petitioner, is wholly arbitrary, unreasonable, and void, and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

3. That Section 201, Chapter 101 of the Public Laws of North Carolina for 1925, as construed and applied to the [fol. 71] petitioner, is wholly arbitrary, unreasonable, and void, and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

4. That as to each of the taxes here drawn in question, the assessment of an income tax against petitioner upon that portion of its income that is not derived from its business in North Carolina is wholly arbitrary, unreasonable, and void; and the collection of said taxes here complained of is and was contrary to and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

5. That the petitioner is entitled to a refund of $3,959.80, with interest from March 11, 1924, and to a refund of $2,124.65, with interest from August 13, 1925, on the income tax paid for the year 1923.

6. That the petitioner is entitled to a refund of $5,221.90, with interest from March 14, 1925, and to a refund of $1,536.77, with interest from August 13, 1925, on the income tax paid for the year 1924.

7. That the petitioner is entitled to a refund of $3,453.28, with interest from March 15, 1926, and to a refund of $444.11, with interest from August 13, 1926, on income tax paid for the year 1925.

8. That the petitioner is entitled to a refund of $3,651.46, with interest from April 11, 1927, on the income tax paid for the year 1926.

Dec. 17th, 1927.
Respectfully submitted.
Louis H. Porter, 30 Broad Street, New York City, of Counsel. Harkins & Vanwinkle, Asheville, N. C., Attorneys for Petitioner.

[fol. 72] BEFORE COMMISSIONER OF REVENUE

FINDINGS OF FACT AND CONCLUSIONS OF LAW—Febr. 22, 1928

The above corporation having petitioned the Commissioner for revision of taxes assessed against it for the above years as provided in Section 340 of the Revenue Act and hearing having been granted the petitioner as provided in the same Section the Commission has determined that the tax is not excessive based upon the following facts and law:

1. The petitioner, Hans Rees' Sons, Incorporated, is a foreign (to North Carolina) corporation, organized and existing under the laws of the State of New York, having its principal office and place of business in New York City, is domesticated and authorized to do business in the State of North Carolina, that on or about March 11, 1924, the corporation duly filed with the Commissioner of Revenue of North Carolina an income tax report on form prescribed by the Department of Revenue which showed net income of the corporation for the year 1923 to be $230,279.40. The report showed also nature of the business of the petitioner and purported to show the assets of the corporation as a whole and in North Carolina as provided in Section 311 of the Act. The allocation arrived at by the petitioner as appeared on said report was 57.32% of assets located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina it gave North Carolina an income of $131,996.15. Tax at 3% upon such apportioned net income was assessed against the corporation and amounted to $3,959.88, which was duly paid

on or about March 11, 1924, to the Commissioner of Revenue, at Raleigh, North Carolina.

During July, 1926, the Commissioner had his Deputy investigate reports for 1923, 1924, and 1925. Upon said investigation it was found that the income reported on previous return, by reason of a few minor discrepancies, should [fol. 73] be $231,927.90. It was further found that the corporation in arriving at the income allocated to North Carolina had included in assets both tangible and intangible assets, disregarding the provision of Section 311 of the Revenue Act which specifies that only real estate and tangible personal property may be used in such allocation. Applying Section 311 literally the investigation resulted in greatly reducing the total amount of assets upon which to base allocation for the purpose of arriving at the amount of income taxable to North Carolina. It was found that 83.7% of the total net income for the year 1923 should be taxed by North Carolina. Accordingly, the Commissioner of Revenue did on or about July 28, 1926, make additional assessment as per the above percentage on an additional income of $62,127.50, amounting to additional tax of $1,863.73 and interest of $260.92, making total of $2,124.65.

On or about August 13, 1926, the corporation paid said additional tax under protest, stating additional tax was illegal and void and it should not be compelled to pay same and reserving the right to contest the legality of said tax in subsequent proceedings.

2. That on or about March 14, 1925, the corporation duly filed with the Commissioner of Revenue of North Carolina an income tax report on form prescribed by the Department of Revenue which showed net income of the corporation for the year 1924 to be $253,921.82. The report showed also nature of the business of the petitioner and purported to show the assets of the corporation as a whole and in North Carolina as provided in Section 311 of the Act. The allocation arrived at by the petitioner as appeared on said report was 68.55% of assets located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina it gave North Carolina an income of $174,063.41. Tax at 3% upon such apportioned net income was assessed against the corporation and amounted

to $5,221.90, which was duly paid on or about March 14, 1925, to the Commissioner of Revenue at Raleigh, North Carolina.

[fol. 74] During July, 1926, the Commissioner had his Deputy to investigate reports for 1924. Upon said investigation it was found that the income reported on previous return was approximately correct. It was found that the corporation in arriving at the income allocated to North Carolina had included in assets both tangible and intangible assets, disregarding the provision of Section 311 of the Revenue Act which specifies that only real estate and tangible personal property may be used in such allocation. Applying Section 311 literally the investigation resulted in greatly reducing the total amount of assets upon which to base allocation for the purpose of arriving at the amount of income taxable to North Carolina. It was found that 85.89% of the total net income for the year 1924 should be taxed by North Carolina. Accordingly, the Commissioner of Revenue did on or about July 28, 1926, make additional assessment as per the above percentage on an additional income of $47,431.18, amounting to additional tax of $1,422.94, and interest of $113.83, making total of $1,536.77.

On or about August 13, 1926, the corporation paid said additional tax under protest, stating additional tax was illegal and void and it should not be compelled to pay same and reserving the right to contest the legality of said tax in subsequent proceedings.

3. That on or about March 15, 1926, the corporation duly filed with the Commissioner of Revenue of North Carolina an income tax report on form prescribed by the Department of Revenue which showed net income of the corporation for the year 1925 to be $139,043.43. The report showed also nature of the business of the petitioner and purported to show the assets of the corporation as a whole and in North Carolina as provided in Section 311 of the Act. The allocation arrived at by the petitioner as appeared on said report was 62.09% of assets located in North Carolina. Applying this percentage as an apportionment of income allocated to North Carolina it gave North Carolina an income of $86,332.06. Tax at 4% upon such apportioned net income was assessed against the corporation and amounted [fol. 75] to $3,453.28, which was duly paid on or about

March 15, 1926, to the Commissioner of Revenue, at Raleigh, North Carolina.

During July, 1926, the Commissioner had his Deputy investigate reports for 1925. Upon said investigation it was found that the income reported on previous return, by reason of a few minor discrepancies, should be $146,561.43. It was further found that the corporation in arriving at the income allocated to North Carolina had included in assets both tangible and intangible assets, disregarding the provision of Section 311 of the Revenue Act which specifies that only real estate and tangible personal property may be used in such allocation. Applying Section 311 literally the investigation resulted in greatly reducing the total amount of assets upon which to base allocation for the purpose of arriving at the amount of income taxable to North Carolina. It was found that 66.32% of the total net income for the year 1925 should be taxed by North Carolina. Accordingly, the Commissioner of Revenue did on or about July 28, 1926, make additional assessment as per the above percentage on an additional income of $10,885.07, amounting to additional tax of $435.40 and interest of $8.71, making total of $444.11.

On or about August 13, 1926, the corporation paid said additional tax under protest, stating additional tax was illegal and void and it should not be compelled to pay same and reserving the right to contest the legality of said tax in subsequent proceedings.

4. That on or about April 11, 1927, after having obtained extension of time within which to file return for the year 1926, the corporation duly filed with the Commissioner of Revenue of North Carolina an income tax report on form prescribed by the Department of Revenue which showed net income of the corporation for the year 1926 to be $106,727.55. The report showed also nature of the business of the petitioner and purported to show the assets of the corporation as a whole and in North Carolina as provided in Section 311 of the Act. In said report the petitioner ap- [fol. 76] portioned its income in the manner prescribed by the Commissioner, through his Agent, at the time investigation was made for the years 1923, 1924 and 1925 that is—using only such assets as the Commissioner thought proper under the law and upon that basis allocated to North Carolina 85.5326% of its total income or a net income of $91,-

286.48. Tax at 4% was assessed in the sum of $3,651.46 and was paid under protest to the Commissioner of Revenue, at Raleigh, North Carolina, claiming tax to be illegal and void and reserving the right to contest such legality in subsequent proceedings. Said tax was paid on or about April 11, 1927, prior to the termination of extension granted.

5. Section 311 of the Revenue Act of 1927, which is a repetition of similar Sections in all previous Acts, provides "In case of a company deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it" shall be the proportion of income taxable to North Carolina.

Sub-section "C" of the same paragraph defines personal tangible property to mean corporeal personal property such as machinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money, deposits in bank, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt.

Under the statutory definition of tangible property and the distinct method provided for determining income of foreign corporations taxable in North Carolina, the Commissioner does not feel that the tax collected is excessive or unfair, and, therefore, denies the petition.

Respectfully submitted.

R. A. Doughton, Commissioner of Revenue.

[fol. 77] BEFORE COMMISSIONER OF REVENUE

EXCEPTIONS TO THE FINDINGS OF FACT AND CONCLUSIONS OF LAW MADE BY THE COMMISSIONER OF REVENUE—Filed Mar. 5, 1928

To the Commissioner of Revenue of the State of North Carolina:

The undersigned petitioner respectfully files the following exceptions to the findings of fact and conclusions of

law contained in the denial of its petition for the revision of income taxes assessed against it for the years 1923, 1924, 1925 and 1926; as is hereinafter more fully set forth, and prays for a ruling upon each and every said exception by the Commissioner of Revenue:

1. Petitioner excepts to the denial of its petition by the Commissioner of Revenue.

2. Petitioner excepts to the findings of fact of the Commissioner of Revenue, in so far as such findings failed to find or refused to find the full copies of the returns made by the petitioner for the years 1923, 1924, 1925 and 1926 for the corporation income tax.

3. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the petitioner is engaged in the business of buying hides, tanning the hides into leather, and selling the leather to customers throughout the United States. It owns a tannery and appurtenances at Asheville, North Carolina, where is performs substantially all of its manufacturing operations. It also owns certain bark lands in North Carolina which are held as reserve supply of raw material, but during none of the years in question has it cut any bark [fol. 78] on any of these lands which it owns, nor used any of the produce of said lands in its business.

4. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That only a negligible amount of its hides, or other raw materials, is purchased in North Carolina. Substantially all of its hides are purchased in Chicago, Illinois, and are shipped from Chicago to Asheville, North Carolina. Its sales are practically none of them made from North Carolina and are substantially all made from petitioner's head office in New York City. Those sales which are not made from New York are made by salesman who travel in its behalf throughout the different states of the United States, and practically all of its sales are made in Interstate Commerce by shipments to customers throughout the United States.

5. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That a portion of the leather, when tanned at its Asheville tannery and ready for sale, is shipped to the petitioner's store in New York City and is then sold from its New York store to customers. The largest part of its sales are shipped by petitioner direct from the tannery in Asheville to customers throughout the United States, practically all of whom are outside of North Carolina. That the orders for such sales are received in the New York office of the petitioner, and instructions are sent from the New York office to the tannery at Asheville to ship a stipulated quantity of leather to a stipulated customer at a stipulated address. Bill for the sales so made are sent to the customer from the petitioner's New York office, and all remittances are made to the petitioner's New York office.

6. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

[fol. 79] That all of the petitioner's banking and other business is done in New York City, with the exception of small bank accounts which are carried in Asheville for the purpose of paying the pay-rolls and other manufacturing bills.

7. The peti--oner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

The petitioner's net income is derived from a continuous business consisting of buying the hides and other raw materials outside the State of North Carolina, shipping these materials to its tannery at Asheville, manufacturing the hides into leather in the State of North Carolina, and selling the leather outside the State of North Carolina. The net income from the petitioner's business is not separated on its books so as to show separately a manufacturing profit and a selling profit, the entire profit appearing from the sale of the goods.

8. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the leather which is made from the hide is of a different quality and a different value from different parts of the hide. The hide is bought at a flat average price per pound and is tanned in a single piece, after which the tanned hide is cut up. The back, sides, and shoulders are better and of more valuable quality of leather, and are sold for belting and other similar purposes. The bellies and heads are of inferior quality of leather, and are sold at a lower price in another market. That most of the large tanners of the country sell the back, sides, and shoulders as a single piece, which is called a butt. The bellies and heads are sold seperately to another market. The petitioner sells its bellies and heads in the same way that other tanners sell them, but it makes little money on its sales of bellies and heads. The petitioner does not sell its butts, as do most of the other large tanners of the country, as a single piece. The trade of the petitioner is largely to small manufacturers; and instead of selling an entire butt to them, the [fol. 80] petitioner cuts the butt up and finishes it to meet the particular requirements of the individual customer; and for these smaller pieces of leather so cut up and sold, the petitioner receives a much higher price than the prevailing market price of entire butts. Substantially all of the profit made by the petitioner is derived from the manipulation of the butt and selling it in such a way that the petitioner receives a larger price than the prevailing market price for butts.

9. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

The cost of buying the hides and tanning the leather at the petitioner's plant is such that the cost of the butts frequently exceeds the market selling price of butts tanned at other tanneries. From time to time the petitioner buys butts, which it finishes, cut up, and sells to its customers; and in such case the profit per pound on the resale of the leather purchased is usually more than the profit per pound on the leather tanned at the same time in the petitioner's own factory: In the year 1919 when the petitioner bought these butts quite extensively, it made a profit on the sale of leather cut up from these butts of 22.26 cents a pound, while in the same year its profit on leather cut from butts

which it had tanned in its own factory was only 13.57 cents a pound.

10. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That many tanners, either because of insufficient capital or for other reasons, do not purchase hides and tan them for their own account, but enter into tanning contracts with packers or others who kill cattle and own the hides. Under these tanning contracts the tanners are paid a fixed price per pound for tanning hides into leather, and the leather belongs to the packer or the owner of the hide. During the year 1926 the price of such tanning contracts [fol. 81] ranged from 11 cents to 13 cents a pound, with an average price of about 12 cents. During the year 1925 the price of such tanning contracts ranged from 11 cents to 12 cents a pound, with an average price of about 12 cents. During the year 1924 there were very few tanning contracts made so that no average price is available. During the year 1923 the price of such tanning contracts ranged from 14 cents to 15 cents a pound, with an average price of about 14½ cents. That petitioner could have had its hides tanned for it by others on one of these tanning contracts, so that the profit or loss of petitioner from its tanning operations may be computed by multiplying the pounds of leather it tanned by the difference between the actual tanning cost per pound and the cost per pound which it would have had under one of these tanning contracts.

11. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the difference between selling entire butts and cutting the butt up and selling it in pieces, as the petitioner does, is substantially the difference between a wholesale and a retail business.

12. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the process of converting green hides into marketable leather takes several months. The price of hides fluctuates quite widely and often suddenly. On the other

hand, the price of leather fluctuates much more slowly, and usually does not reflect the smaller fluctuations in the price of leather. The profit or loss in the tanning business is therefore largely dependent on the skill with which the tanner buys his hides, and it may be approximately measured by the difference between the average market prices of hides and the actual cost of hides to the individual tanner. In petitioner's case the hides are substantially all purchased outside of the State of North Carolina, and have [fol. 82] been bought with such skill that the cost of its hides in the years in question has usually been substantially less than the average price of similar hides in the respective years.

13. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1926 the average market price of bellies was 27 cents a pound, and the average price received by petitioner in 1926 for bellies was 26.48 cents a pound. In the same year the average market price of heads was 16 cents a pound, and the average price received by the petitioner was 14.61 cents a pound.

14. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1925 the average market price for bellies was 24½ cents a pound, and the average price received by petitioner in 1925 for bellies was 23 cents a pound. In the same year the average market price of heads was 15 cents a pound, while the average price received by petitioner was 12 cents a pound.

15. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1924 the average market price for bellies was 20.75 cents a pound, and the average price received by petitioner in 1924 for bellies was 19.17 cents a pound. In the same year the average market price of heads was 12.5 cents a pound, while the average price received by petitioner was 9.6 cents a pound.

16. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1923 the average market price for bellies was 24 cents a pound, and the average price re- [fol. 83] ceived by petitioner in 1923 for bellies was 19.95 cents a pound. In the same year the average market price of heads was 13 cents a pound, while the average price received by petitioner was 10.34 cents a pound.

17. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the average market selling price of butts for the year 1926 was 55.8665 cents per pound. The petitioner received in 1926 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 67.943 cents per pound. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1926, to 6.052 cents per pound. Allowing for the finishing cost, during the year 1926 the petitioner received an average price of 6.025 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During the year 1926 the petitioner sold 3,239,904 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $195,204.22 more than would have been received had these butts been sold as butts at the current market prices for that year. This amount of $195,204.22 exceeds the total net profits of the petitioner for the year 1926, indicating that the tanning operations of the petitioner were conducted at an actual loss.

18. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the average market selling price of butts for the year 1925 was 57.666 cents per pound. The petitioner received in 1925 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 68.45 cents per pound. The average cost to the petitioner of finishing and cutting up these

[fol. 84] butts amounted, in 1925, to 5.455 cents per pound. Allowing for this finishing cost, during the year 1925 the petitioner received an average price of 5.33 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During the year 1925 the petitioner sold 3,134,445 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $167,065.92 more than would have been received had these butts been sold as butts *of* the current market prices for that year.

19. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the average market selling price of butts for the year 1924 was 55.25 cents per pound. The petitioner received in 1924 an average price per pound for the leather which it made by manipulating and finishing and cutting up the butts it tanned of 68.96 cents per pound. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1924, to 4.953 cents per pound. Allowing for this finishing cost, during the year 1924 the petitioner received an average price of 8.757 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During the year 1924 the petitioner sold 2,888,785 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $252,970.90 more than would have been received had these butts been sold as butts at the current market prices for that year.

20. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the average market selling price of butts for the year 1923 was 67.521 cents per pound. The petitioner received in 1923 an average price per pound for the leather [fol. 85] which it made by manipulating and finishing and cutting up the butts it tanned of 78.33 cents per pound. The average cost to the petitioner of finishing and cutting up these butts amounted, in 1923, to 4.718 cents per pound. Allowing for this finishing cost, during the year 1923 the

petitioner received an average price of 6.091 cents per pound more for the leather that it sold from the butts which it tanned than the average market price for the butts. During the year 1923 the petitioner sold 3,033,933 pounds of leather made from butts, and the total gain received by it on the sale of this class of leather was, therefore, a total of $184,796.70 more than would have been received had these butts been sold as butts at the current market prices for that year.

21. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That petitioner has for many years separated its accounts between its wholesale business and its retail business. The wholesale business consists chiefly of bellies and heads, which are ordinarily sold in carload lots and in the same way that most other tanners sell their product. This business is called on the petitioner's books by the arbitrary term of "Merchandise Sales." The retail part of petitioner's business is called on its books "Curried and Specialty," and this is all sold in less than carload lots.

22. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1926 the petitioner's Merchandise Sales amounted to $671,800.16, with a gross profit of $35,782.30, or a gross profit on sales of 5.54%. The retail business of petitioner for the year 1926 had gross sales of $1,676,776.75, with a gross profit of $133,468.60, or 8% on sales. Had petitioner purchased butts in the open market during the year 1926 at an average cost of 55.8665 cents per pound, and [fol. 86] of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $61,735.62 greater than it actually was, or $195,204.22 as shown in Finding No. 21.

23. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1925 the petitioner's Merchandise Sales amounted to $705,590.31, with a gross profit of $70,322.17, or a gross profit on sales of 9.97%. The retail business of petitioner for the year 1925 had gross sales of $1,648,112.26, with a gross profit of $251,952.70, or 15.29% on sales. Had petitioner purchased butts in the open market during the year 1925 at an average cost of 57.666 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $84,886.88 less than it actually was, or $167,065.92 as shown in Finding No. 22.

24. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1924 the petitioner's Merchandise Sales amounted to $566,856.15, with a gross profit of $98,708.12, or a gross profit on sales of 17.41%. The retail business of petitioner for the year 1924 had gross sales of $1,549,188.09, with a gross profit of $304,578.55, or 19.66% on sales. Had petitioner purchased butts in the open market during the year 1924 at an average cost of 55.25 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased leather, and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $51,607.65 less than it actually was, or $252,970.90 as shown in Finding No. 23.

[fol. 87] 25. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1923 the Petitioner's Merchandise Sales amounted to $639,006.67, with a gross profit of $69,713.85, or a gross profit on sales of 10.91%. The retail business of petitioner for the year 1923 had gross sales of $1,901,930.41, with a gross profit of $330,699.95, or 17.39% on sales. Had petitioner purchased butts in the open market during the year 1923 at an average cost of 67.521 cents per pound, and of a quantity equal to that actually sold by it during the year, and had refinished and cut up this purchased

leather, and sold it instead of the leather that it actually tanned, its gross profits on said retail business would have been $145,903.25 less than it actually was, or $184,796.70, as shown in Finding No. 24.

26. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That petitioner's actual cost of tanning leather in its own tannery in 1926 was 13.84 cents per pound. During the year 1926 the petitioner tanned 5,299,637 pounds of leather. Its actual cost of tanning this leather was, therefore, $99,493.39 more than the tanning cost would have been based on the average price of tanning contracts in effect during that year.

27. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That petitioner's actual cost of tanning leather in its own tannery in 1925 was 13.67 cents per pound. During the year 1925 the petitioner tanned 4,796,036 pounds of leather. Its actual cost of tanning this leather was, therefore, $80,093.80 more than the tanning cost would have been based on the average price of tanning contracts in effect that year.

28. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

[fol. 88] That petitioner's actual cost of tanning leather in its own factory in 1924 was 12.97 cents per pound. During the year 1924 the petitioner tanned 4,835,888 pounds of leather. Its actual cost of tanning this leather was therefore $627,214.67. Because of the absence of data as to tanning contracts this year, it is impossible to show the relative tanning cost.

29. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That petitioner's actual cost of tanning leather in its own factory in 1923 was 13.95 cents per pound. During the year 1923 the petitioner tanned 5,091,311 pounds of leather. Its actual cost of tanning this leather was therefore $28,-

002.21 less than the tanning cost would have been based on the average price of tanning contracts in effect that year.

30. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

During the year 1926 Packer steer hides varied in market price from 11.5 cents to 16 cents a pound, with an average price for the year of 14 cents a pound. During this year petitioner purchased 4,491,759 pounds of Packer steer hides at an actual cost of 13.42 cents a pound. Its actual cost of steer hides was therefore .58 cents a pound, or $26,052.20 less than it would have been had these hides been purchased at the average market price. During the same year Packer cow hides varied in market price from 11 cents to 14.5 cents a pound, with an average price for the year of 13 cents a pound. During the year petitioner purchased 1,302,099 pounds of Packer cow hides at an actual cost of 12.58 cents a pound. Its actual cost of cow hides was therefore .42 cents a pound, or $5,468.81 less than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1926 was $31,521.01 greater than it would have been had its hides been purchased in regular course at average market prices.

[fol. 89] 31. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

During the year 1925 Packer steer hides varied in market price from 14 cents to 17½ cents a pound, with an average price for the year of 16 cents a pound. During this year petitioner purchased 5,052,552 pounds of Packer steer hides at an actual cost of 15.44 cents a pound. Its actual cost of steer hides was therefore .56 cents a pound, or $28,294.29 less than it would have been had these hides been purchased at the average market price. During the same year Packer cow hides varied in market price from 14 cents to 16 cents a pound, with an average price for the year of 14¾ cents a pound. During the year petitioner purchased 708,551 pounds of Packer cow hides at an actual cost of 14.35 cents a pound. Its actual cost of cow hides was therefore .4 cents a pound, or $2,834.20 less than it would have been had these

hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1925 was $31,128.49 greater than it would have been had its hides been purchased in regular course at average market prices.

32. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

During the year 1924 Packer steer hides varied in market price from 10¾ cents to 18 cents a pound, with an average price for the year of 14½ cents a pound. During this year petitioner purchased 5,782,409 pounds of Packer steer hides at an actual cost of 13.14 cents a pound. Its actual cost of steer hides was therefore 1.36 cents a pound, or $78,640.76 less than it would have been had these hides been purchased at the average market price. During the same year Packer cow hides varied in market price from 9 cents to 15½ cents a pound, with an average price for the year of 12 cents a pound. During the year petitioner purchased 675,383 pounds of Packer cow hides at an actual cost of 9.87 cents [fol. 90] a pound. Its actual cost of cow hides was therefore 2.13 cents a pound, or $14,385.66 less than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1924 was $93,026.42 greater than it would have been had its hides been purchased in regular course at average market prices.

33. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

During the year 1923 Packer steer hides varied in market price from 13½ cents to 20½ cents a pound, with an average price for the year of 16¾ cents a pound. During this year petitioner purchased 4,834,375 pounds of Packer steer hides at an actual cost of 14.8 cents a pound. Its actual cost of steer hides was therefore 1.95 cents a pound, or $94,270.31 less than it would have been had these hides been purchased at the average market price. During the same year Packer cow hides varied in market price from 10 cents to 16 cents a pound, with an average price for the year of 13 cents a pound. During the year petitioner purchased 1,401,746

pounds of Packer cow hides at an actual cost of 15.64 cents a pound. Its actual cost of cow hides was therefore 2.64 cents a pound, or $37,006.09 more than it would have been had these hides been purchased at the average market price. As a direct result of its hide purchasing operations, its gross profit for the year 1923 was $57,264.22 greater than it would have been had its hides been purchased in regular course at average market prices.

34. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1926 the petitioner's gross sales amounted to $2,451,738.44, and its sales to customers in the State of North Carolina during that period amounted to $6,376.01.

[fol. 91] 35. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1925 the petitioner's gross sales amounted to $2,413,581.71, and its sales to customers in the State of North Carolina during that period amounted to $7,603.76.

36. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1924 the petitioner's gross sales amounted to $2,167,000.51, and its sales to customers in the State of North Carolina during that period amounted to $4,817.73.

37. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That during the year 1923 the petitioner's gross sales amounted to $2,598,332.56, and its sales to customers in the State of North Carolina during that period amounted to $6,727.14.

38. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the petitioner for 1926 had total assets of $2,448,-041.64, and its net profits amounted to $106,727.65, or 4.37% earned on its assets, and its total net sales amounted to $2,309,070.15, so that its profit on sales was 4.6%.

39. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the petitioner for 1925 had total assets of $2,409,-377.06, and its net profits amounted to $139,043.43, or 5¾% earned on its assets, and its total net sales amounted to $2,286,731.86, so that its profit on sales was 6%.

[fol. 92] 40. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the petitioner for 1924 had total assets of $2,357,-029.33, and its net profits amounted to $253,921.82, or 10.8% earned on its assets, and its total net sales amounted to $2,109,021.39, so that its profit on sales was 12%.

41. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That the petitioner for 1923 had total assets of $1,693,-385.10, and its net profits amounted to $230,279.40, or 14.2% earned on its assets, and its total net sales amounted to $2,485,867.55, so that its profits on sales was 9.2%.

42. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following findings of fact:

The income of petitioner flows from three sources—to wit: a profit on buying hides at less than market, a manufacturing profit on tanning the leather, and a selling profit largely arising from its method of selling at retail instead of wholesale. The data contained in other findings affords an approximate relative proportion of these items of profit.

In the year 1926 this method of computation indicates a buying profit of $31,521.01, a selling profit of $195,204.22, and a manufacturing loss of $61,735.62 or a total gross profit of $164,989.61. The actual gross profit was $169,-250.90, or very close to the total reached by determination of income by source. None of the income had its source in manufacture in North Carolina this year.

In the year 1925 this method of computation indicates a buying profit of $31,128.49, a tanning profit of $84,886.88, and a seling profit of $167,065.92, or a total gross profit of $283,081.29. As the actual gross profit was $322,274.87, in this year there was a profit of $39,193.59 (or about 14% of the total) not distributed on this allocation of profits. This [fol. 93] allocation indicates that in the year 1925 about 26% of the income had its source in the manufacturing operations in the State of North Carolina.

In the year 1924 this method of computation indicates a buying profit of $93,026.42, a tanning profit of $51,607.65, and a selling profit of $252,970.90, or a total gross profit of $397,604.97. The actual gross profit was $403,286.67, or very close to the total reached by determination of income by source. This allocation indicates that in the year 1924 about 13% of the income had its source in the manufacturing operations in the State of North Carolina.

In the year 1923 this method of computation indicates a buying profit of $57,244.22, a tanning profit of $145,903.25, and a selling profit of $184,796.70, or a total gross profit of $387,944.17. The actual gross profit was $400,413.80, or very close to the total reached by determination of income by source. This allocation indicates that in the year 1923 about 37% of the income had its source in the manufacturing operations in the State of North Carolina.

For the four years in question an average of about 17% of petitioner's income was derived from the manufacturing operations of the petitioner conducted within the State of North Carolina, and that during said years 83% of petitioner's total income had its source wholly without the State of North Carolina and arose from the buying and merchandising operations of the petitioner conducted wholly without the State of North Carolina.

43. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

The per cent of profit on money invested in the business, and the per cent of profit on sales of those companies which do primarily a wholesale business, and whose profit therefore is primarily attributable to the manufacturing operations, is very much less than that of the petitioner. For example, the Central Leather Company claims to own two-

[fol. 94] thirds of the total production capacity of the entire country for heavy leather. In 1926 it had assets of $90,118,174.37, and showed net earnings for the year ending December 31, 1926, before deducting discount on bonds, of $1,494,919.58, or about 1.6% on its assets. In 1925 it had assets of $91,789,050.52; for the year ending December 31, 1925, before deducting interest, its profits were $2,548,-014.59, or about 2¾% on its assets. In 1924 this company showed net earnings before deducting interest of $1,353,-900.85, and after deducting interest a net loss of $484,-306.65; and for the year 1923 it showed a net loss of $5,434,-035.44. This company does not report its gross sales, so that it is impossible to compute the relation of profits to sales.

The National Leather Company in 1926 had total assets of $22,593,388.35. Its sales in that year amounted to $24,556,398.24. It sustained a net loss before deducting interest of $239,823.43. In 1925 it had total assets of $25,358,684.50. Its total sales in that year amounted to $25,837,340.88. Its net profit before deducting interest was $720,557.53. That is, it earned about 2.8% on its assets, and made about 2¾% on its sales. In 1924 it had total assets of $28,365,474.67. Its total sales in that year amounted to $26,520,817.81. Its net profit before deducting interest was $951,387.31. That is, it earned about 3.4% on its assets, and made about 3.6% on its sales. In 1923 it had total assets of $30,327,610. Its total sales in that year amounted to $28,441,140. Its net profit before deducting interest was $2,278,239. That is, it earned about 7½% on its assets, and made about 8% on its sales.

The Pfister & Vogel Leather Company had in 1926 assets of $15,287,816.79. Its report does not show its profits or sales for 1926. In 1925 it had assets of $17,390,967.76. Its net profit before interest was $135,523.92, or only about 8/10 of 1% on its assets.

44. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

[fol. 95] That the petitioner has complied with all of the provisions of law authorizing it to do business in North Carolina, and has paid all taxes assessed against it in said State; that the income taxes complained of in said petition

are not commutation taxes, or taxes levied in lieu of or to take the place of other taxes; that the petitioner has paid other taxes in North Carolina as follows:

For the year 1923 the petitioner paid the City of Asheville taxes of	$9,434.46
Asheville City Franchise Tax	150.00
County Taxes	7,624.58
State Franchise Tax	622.70
Taxes upon land owned by it in Western North Carolina amounting to	1,217.48
Or a total of	$19,049.22
For the year 1924 the petitioner paid Asheville City Taxes amounting to	$9,014.08
Asheville City Franchise Tax	150.00
County Taxes	5,874.86
State Franchise Tax	573.20
Taxes upon land owned by it in Western North Carolina amounting to	1,264.03
Or a total of	$16,876.17
For the year 1925 the petitioner paid Asheville City Taxes of	$10,969.47
Asheville City Franchise Tax	150.00
County Taxes	7,149.30
State Franchise Tax	902.69
Taxes on land, amounting to	1,534.07
Or a total of	$20,705.53
[fol. 96] For the year 1926 the petitioner paid Asheville City Taxes of	$11,107.56
City Franchise Tax	150.00
County Taxes of	9,501.56
State Franchise Tax	902.69
Taxes upon land of	1,560.88
Or a total of	$23,222.69

45. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1926 the asset side of the balance sheet of the petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina was as follows:

Cash on hand in New York		$150,705 83
Cash on hand in Asheville		11,155 48
Notes Receivable ($117.37) past due		20,117 37
Customers' accounts—less reserve for doubtful 1926—$10,000.00 and disconnts 1926—$11,183.48; 1925—$12,667.21		237,338 32
Sundry accounts receivable and loans		4,003 80
Accrued interest on notes receivable		1,000 00
Merchandise in New York and in transit		246,185 89
Merchandise in Asheville		233,194 76
Hides, leather in process, bark, supplies, etc., at tannery		521,959 43
Due from Hans Rees' Sons Company		76,474 02
Tanners Products Company stock—140 shares at cost		17,200 00
Hans Rees' Sons Company stock—100 shares at par		10,000.00
[fol. 97] Bark lands, North Carolina	$29,820 63	
Real Estate at Asheville	40,000 00	
Buildings and machinery at Asheville	1,064,367 97	
Delivery equipment at Asheville	6,205 00	
Tools, furniture and office improvements, New York	21,431 84	
	$1,161,825 44	
Less reserve for depreciation	350,489 70	
Net book value		811,335 74
Good-will		100,000 00
Insurance premium—Unexpired portion		7,371 00
		$2,448,041.64

46. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following findings of fact:

For the year 1925 the asset side of the balance sheet of petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York		$97,392.09
Cash on hand in Asheville, N. C.		1,845.09
Book accounts—Good		361,421.90
Bills receivable		0.00
Due from Employees		300.00
Insurance paid in advance		1,500.00
Stocks and Bonds		24,500.00
Merchandise stock in New York and in transit		243,327.01
Merchandise stock in Asheville, N. C.		161,647.48
Hides, leather in process, bark, supplies, etc. at [fol. 98] Bark lands, North Carotannery		599,550.29
lina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings and machinery at Asheville	1,031,988.91	
Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvements, New York	23,465.31	
	$1,142,572.35	
Less reserve for depreciation	306,679.52	
Net book value		835,892.83
Good-will		100,000.00
		$2,409,377.06

47. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1924 the asset side of the balance sheet of the petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York		$120,677 11
Cash on hand in Asheville, N. C.		1,152 18
Books Accounts—Good		312,519 71
Bills Receivable		1,282 70
Due from Employees		300 00
Insurance paid in advance		1,500 00
Interest & Accounting		0 00
Stocks & Bonds		24,500 00
Merchandise stock in New York and in transit		248,145 07
Merchandise stock in Asheville, N. C.		146,864 34
Hides, leather in process, bark, supplies, etc., at tannery		554,343 43
Forward		$1,412,284 54
[fol. 99] Amount Brought Forward		$1,412,284 50
Bark lands, North Carolina	$40,913 13	
Real estate at Asheville	40,000 00	
Building & Machinery, Asheville	997,183 95	
Delivery equipment at Asheville	6,205 00	
Tools, furniture and office improvements, New York	25,803 88	
	$1,110,105 96	
Less reserve for depreciation	264,361 17	
Net book value		845,744 79
Good-will		100,000 00
		$2,357,029 33

48. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

For the year 1923 the asset side of the balance sheet of the petitioner, showing the assets segregated as to their location within the State of North Carolina and without the State of North Carolina, was as follows:

Cash on hand in New York	$143,615 02
Cash on hand in Asheville, N. C.	6,879 75
Book Accounts—Good	267,090 80
Bills Receivable	0 00

Due from Employees		578.29
Insurance paid in advance		1,500.00
Interest paid in advance		307.10
Accounting paid in advance		800.00
Stocks and Bonds		24,500.00
Merchandise stock in New York and in transit		226,479.13
Merchandise stock in Asheville, N. C.		149,279.24
[fol. 100] Hides, leather in process, bark, supplies, etc., at tannery		481,380.65
Bark lands, North Carolina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings and machinery at Asheville	433,715.69	
Delivery equipment at Asheville	5,845.32	
Tools, furniture and office improvements, New York	28,270.83	
	$548,744.97	
Less reserve or depreciation	257,769.85	
Net book value		290,975.12
Good-will		100,000.00
		$1,693,385.10

49. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or refuse to find the following finding of fact:

That for each of the years here drawn in question a tax has been assessed in accordance with the laws of the State of North Carolina upon that portion of petitioner's total income that the tangible assets in the State of North Carolina bear to the tangible assets wherever located, and that in making such apportionment no regard was had to the location of intangible assets or to the particular nature of the petitioner's business or to the actual source of petitioner's income.

50. The petitioner excepts to the said findings of fact of the Commissioner of Revenue in so far as they fail or defuse to find the following finding of fact:

That for each of the taxes here drawn in question, the method of apportioning petitioner's income results, in pe-

[fol. 101] titioner's case, in subjecting to tax by North Carolina a larger amount of income than in fact has its source in North Carolina, so that the taxes here complained of are in part assessed against income derived by this foreign corporation from sources entirely without the State of North Carolina.

51. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that they failed or refused to find the following conclusion of law:

That the State of North Carolina cannot constitutionally levy an income tax upon that portion of the petitioner's income that has its source outside the State of North Carolina.

52. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that it failed or refused to find the following conclusion of law:

That Section 201, Chapter 4, of the Public Laws of North Carolina for 1923, as construed and applied to the petitioner, is wholly arbitrary, unreasonable, and void, and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

53. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that it failed or refused to find the following conclusion of law:

That Section 201, Chapter 101 of the Public Laws of North Carolina for 1925, as construed and applied to the petitioner, is wholly arbitrary, unreasonable, and void, and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States.

54. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that it failed or refused to find the following conclusion of law:

That as to each of the taxes here drawn in question, the assessment of an income tax against petitioner upon that [fol. 102] portion of its income that is not derived from its business in North Carolina is wholly arbitrary, unreason-

able, and void; and the collection of said taxes here complained of is and was contrary to and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

55. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that they failed or refused to find the following conclusion of law:

That the petitioner is entitled to a refund of $3,959.80, with interest from March 11, 1924, and to a refund of $2,124.65, with interest from August 13, 1925, on the income tax paid for the year 1923.

56. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that they failed or refused to find the following conclusion of law:

That the petitioner is entitled to a refund of $5,221.90, with interest from March 14, 1925, and to a refund of $1,536.77, with interest from August 13, 1925, on the income tax paid for the year 1924.

57. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that they failed or refused to find the following conclusion of law:

That the petitioner is entitled to a refund of $3,453.28, with interest from March 15, 1926, and to a refund of $444.11, with interest from August 13, 1926, on the income tax paid for the year 1925.

58. The petitioner excepts to the conclusions of law contained in said report of the Commissioner of Revenue in that they failed or refused to find the following conclusion of law:

That the petitioner is entitled to a refund of $3,651.46, with interest from April 11, 1927, on the income tax paid for the year 1926.

[fol. 103] 59. The petitioner excepts to the conclusions of law of the Commissioner contained in said report which

are to the effect that the taxes collected are not excessive and unfair.

Dated the 2nd day of March, 1928.

Respectfully submitted.

Hans Rees Sons, Inc., by Harkins & Vanwinkle, of Asheville, N. C., Attys. for Petitioner. Louis H. Porter, 30 Broad St., New York City, of Counsel.

BEFORE COMMISSIONER OF REVENUE

ORDER OVERRULING PETITIONER'S EXCEPTIONS TO FINDINGS OF FACT AND CONCLUSIONS OF LAW—Apr. 5, 1928

These causes coming on to be heard upon exceptions to the findings of fact and conclusions of law made by the Commissioner of Revenue and being heard and duly considered, it is ordered, decreed and adjudged that the exceptions filed from 1 to 59 inclusive be and the same are hereby overruled and the prayer of the petitioners for refund of the taxes for the years 1923, 1924, 1925 and 1926 be and the same is hereby denied and disallowed.

This the 5th day of April, 1928.

R. A. Doughton, Commissioner of Revenue.

[fol. 104] BEFORE COMMISSIONER OF REVENUE

NOTICE OF APPEAL—Filed Apr. 13, 1928

To the foregoing order of the Commissioner of Revenue, dated April 5, 1928, overruling the exceptions to the findings of fact and conclusions of law made by the Commissioner of Revenue, and the exceptions filed by the petitioner from No. 1 to No. 59, inclusive, the petitioner excepts and gives notice of appeal to the Superior Court. The petitioner hereby waives a jury trial and asks that the appeal may be had to the Superior Court of Buncombe County where the appellant resides.

The petitioner herewith files its bond in the sum of Two Hundred Dollars ($200) for the costs in this action, with

the United States Fidelity and Guaranty Company as surety, and respectfully prays that the appeal be allowed and the record certified to the Superior Court of Buncombe County.

Dated April 7, 1928.

Hans Rees' Sons, Inc., by Harkins & Van Winkle, Attorneys. Louis H. Porter, of Counsel.

Bond on appeal for $200.00, filed April 13, 1928, omitted in printing.

[fol. 105] Commissioner's certificate to foregoing transcript omitted in printing.

[fol. 106] In Superior Court of Buncombe County

Judgment—Nov. 17, 1928

This cause coming on to be heard before His Honor, McElroy, Judge, jury trial having been waived, it being agreed that His Honor should find the facts with the same force and effect as by jury trial and render judgment thereon, it being admitted that the Commissioner of Revenue in assessing the tax complained of has followed the method set forth in Section 311 of the Revenue Act of 1927, sub-section A, and similar sections of the Act of 1923 and 1925, and that the valuation fixed for the real [fol. 107] estate and tangible property of the complaining taxpayer, both within and without the State, is admitted to be correct, and that the total net income of the complaining taxpayer used for a basis of calculation by the Commissioner of Revenue is admitted to be correct, and that the allocation thereof for the purposes of taxation was made in accordance with the method indicated in the statute referred to, the complaining taxpayer having offered testimony as appears in the record, over the objection of the State, and upon the conclusion of the testimony the State having moved to strike out the testimony offered as immaterial, and the Court being of the opinion that such

testimony is immaterial, allows the motion to strike out and holds upon the admission of the taxpayer that the statutory method has been followed and that the tax levied by the Commissioner of Revenue is a valid tax and that the section authorizing the said levy is not in violation of any constitutional rights of the taxpayer. It is therefore

Ordered and adjudged that the action be dismissed at the cost of the taxpayer. This Nov. 17, 1928.

P. A. McElroy, Judge Presiding.

IN SUPERIOR COURT OF BUNCOMBE COUNTY

Statement of Case and Evidence

This action was originally begun by an application to the Commissioner of Revenue for the rehearing and readjustment of the income tax assessed against the petitioner, Hans Rees' Sons, Inc., by the State of North Carolina for the years 1923, 1924, 1925 and 1926, in accordance with Sections 340 and 341 of Chapter 80 of the Public Laws of 1927. The original petition for the revision of the tax appears in the record and was filed with the Commissioner of Revenue on August 17, 1927.

The petitioner thereafter and on or about the 17th day of December, 1927, requested the Commissioner to make [fol. 108] certain findings of fact and conclusions of law. Thereafter and on the 22nd day of February, 1928, the Commissioner of Revenue made certain findings of fact and conclusions of law, which appear in the record. The petitioner thereupon and on the 5th day of March, 1928, filed formal exceptions to the findings of fact and conclusions of law made by the Commissioner, as appears in the record. Thereafter and upon the 5th day of April, 1928, the Commissioner of Revenue entered his order overruling the petitioner's exceptions to the findings of fact and conclusions of law made by him (Record, p. 103), in which he overruled all of the exceptions filed by the petitioner from 1 to 59, inclusive, and the prayer of the petitioner for a revision of the taxes for the years 1923, 1924, 1925 and 1926 was disallowed.

Thereafter and on the 13th day of April, 1928, petitioner gave formal notice of appeal, waiving a jury trial and asking that the appeal may be had to the Superior Court of Buncombe County, N. C., and duly filed its cost bond in the sum of $200 (Record, p. 104). The Commissioner of Revenue thereupon on the 14th day of April, 1928, duly certified said record to the Superior Court of Buncombe County.

The matter came on for hearing before His Honor, P. A. McElroy, Judge Presiding and Holding the Courts of the Nineteenth Judicial District, at the November, 1928, Superior Court of Buncombe County, and the following is all the evidence introduced at the trial of the case and of the other proceedings had at the trial:

The petitioner offered in evidence the income tax returns filed by it for the years 1923, 1924, 1925 and 1926, which are marked Petitioner's Exhibits 1, 2, 3 and 4 (Record, pp. 66-69), and which are in words and figures as follows:

(Here income tax returns were introduced.)
(Record, pp. 11-14.)

Petitioner introduced a letter from the Department of Revenue to Hans Rees' Sons, Inc., dated August 9, 1926, [fol. 109] to show how the income tax for 1923, 1924, 1925 was reassessed. It was in words and figures as follows:

(Here letter was introduced.) (Record, p. 17.)

It was admitted by all the parties that all the taxes were paid under protest duly filed with the Commissioner.

The petitioner then offered the deposition, duly taken, of Harold B. Rees, and the following stipulations which had been agreed upon by the parties:

It is hereby stipulated between the parties in the above entitled action that the State will not require the original books of the defendant upon which the testimony of the witnesses may be based to be introduced in evidence as a basis of such testimony.

It is further stipulated and agreed that the attorneys or representatives of the State may examine all such books and that at the request of the State the cross-examination of any witness testifying to such computation may be adjourned a reasonable time pending such examination of the original books.

It is further stipulated that the State of North Carolina will not object to any testimony on the ground that the proper foundation of the evidence had not been made by the introduction of the bo-ks of the petitioner into the evidence.

Before the reading of the deposition of Harold B. Rees, the State announced that it would object to all the petitioner's evidence taken by deposition on the ground that it was all immaterial, and His Honor reserved his ruling.

HAROLD B. REES, called as a witness on behalf of the petitioner, being duly sworn, testified as follows:

Direct examination.

By Mr. Greenough:

I am an officer of the petitioner, Hans Rees' Sons, Inc., holding the office of President. The petitioner was incorporated in New York State in October, 1901. Its business is that of tanning, manufacturing and sale of belting and other heavy leathers.

[fol. 110] The business was inaugurated by Mr. Hans Rees, the grandfather of the present generation of Reeses, about 80 years ago. In the early days of the activity of the Company we owned small tanneries in different part of the country, notably Maryland, Pennsylvania and Virginia.

In 1898 we decided to locate at Asheville, North Carolina, because at that time the bark lands and woodlands of Virginia and Pennsylvania and Maryland, which had been the locations for many, many years of the earlier tanneries of the country, were getting denuded of their raw materials; so we went down into more virgin territory—North Carolina, and located at Asheville, because it was at the hub of the mountain districts in which bark and wood could be obtained. We located at Asheville and developed a very much larger plant there than we had ever had before. After the plant there was built and was in full operation, we gradually dismantled and abandoned the smaller plants which we had theretofore operated in different states of the Union.

After Asheville got pretty well going, we branched out considerably there and changed, in a way, our methods of

doing business, in that we divided our business into two parts. One we called the wholesale business and the other the retail.

The wholesale part of the business was the selling of certain parts of the hide which usually go to shoe manufacturers, and others, various classes of low grade leather, and so on; and this wholesale end of the business is on such stock as is usually sold in carload lots, in bulk.

The retail end of our business, which we call the retail end of it, is the better portion of the hide, where we cut it up into innumerable pieces, finish it in various ways and manners, and sell it in less than carload lots. In fact, quite a good deal of business is done by parcel post. That we classify on our books as curried and specialty leathers, and that is as I say sold at retail.

Since the establishment of this business, we have been located out here in the New York swamp. This is the old [fol. 111] leather district of the United States; two or three hundred years ago tanneries were all around in these swamps. Now in digging foundations for big buildings, they find old leather, old coins, and so on. We have always had our headquarters within a stone's throw. We have been in three different locations in the last 80 years. You can throw a stone from this building to the other two. Here we have always had our executive offices and our sales offices, and a cutting plant and a manufacturing plant and our warehouses.

From the New York warehouse all shipments are made that we have the stock on hand for to customers, wherever located. The tannery is used as the manufacturing plant and the supply house, and when we have not the quality or the amount of stock on hand in the New York warehouse that a customer requires, we send a requisition to the plant to ship to New York and from here we ship to customers or sometimes, if an order is urgent, we wire the plant to ship direct to the customer, to save time.

We own various timber tracts in some of the western counties of North Carolina, which were bought some years ago with the idea of conservation and to fall back upon in the case of emergency. I mean by that, if we were not able to buy in the open market the bark and wood that we would

require in any given year, we take it off of our own property.

The petitioner has not cut any timber or bark on these lands during the years 1923, 1924, 1925 and 1926, the years involved in this proceeding, and we have not used any other products of those lands during those years. We have not received any income from the lands during the years referred to but, as a matter of fact, has had the usual taxes to pay on them, together with the expenses of foresters to look after them, to see that we do not have fires; to keep them in proper order, to protect our interests. The value, of these timber lands just described, is carried on our books [fol. 112] at about $40,000, and I think that is the value they were carried at during the years in question—1923, 1924, 1925 and 1926. They have always been carried at cost.

The customers of the petitioner are located throughout the United States, Canada, parts of continental Europe and Great Britain. In fact, we have had, at one time or another, customers all over the world.

We buy most of our green salted hides, which are our basic raw material, from the big packers in the West, like Swift, Armour, Cudahy, Wilson and others. The packing plants from which the hides are derived are located in the big packing centers of the West, like Chicago, Omaha, Kansas City, Sioux City and so on, and we buy their hides.

The method of purchase is through so-called hide brokers. They are an established line of brokers, just as there are cotton brokers and other kinds of brokers. They handle exclusively packer hides; they make that their life work and are pretty well up in it.

The usual practice is for the broker to keep his customer posted as to market conditions surrounding such classes of raw materials as he may wish to buy, and then the buyer sees on this sheet of offerings something that he particularly wants, and he communicates with his broker either by phone or by wire and tells him to buy a certain lot of hides, and when the contract is closed and the time comes to take these hides up, the broker sends an expert inspector who makes his business out of inspecting and taking up hides for a tanner. He sends him to the particular packing plant. He goes to the packing plant, inspects each hide, weighs each hide, tares the hide, keeps a record of them, loads them in

a car and ships them to the tanner. This inspector is acting as a receiving agent for the buyer; he keeps an exact record of all grades, weights and so on, of the particular shipment indicated, and furnishes his original weight sheets to the buyer in order that the buyer, when he gets the bill from the packer, will have something to check the accuracy [fol. 113] of it. The packer's representative keeps the same sort of a bill. They must check or else we have some question to take up.

Hides as a rule are sold sight draft, bill of lading attached, so that it is a quick proposition. A tanner many times has a great many thousands of dollars tied up in hides that he has not seen, which have not yet reached his tannery, but he has paid for them. That is one of the risks of the game.

Tan bark is one of the principal raw products used in the tanning of leather. It comes from the mountains of North Carolina, usually chestnut oak bark peeled by the mountaineer, farmers and contractors and cured by them in the mountains, then delivered to the tannery either by wagon or by motor truck nowadays, or in carload lots, and is paid for by the tannery spot cash, after inspection and weight; chestnut wood, which in recent years has become more and more used in tanning, is bought the same way. We buy it not alone in North Carolina, but we get some from Tennessee and some from South Carolina and adjacent states; that comes in in the same way and is paid for in the same way, spot cash after examination, inspection and weighing. Then another important tanning raw material is quebracho; that is an extract that is made from the wood of a South American hard-wood, being a Spanish word meaning "break axe," which, next to lignum vitæ, is the hardest wood that is known. That wood is shipped to this country port of entry by steamer or sailing vessel in log form and is reduced to extract form at the port of entry and is shipped in tank cars to the different tanneries throughout the country, where it is used the same way as the liquors you make in your tannery of bark or wood for the manufacture of leather.

Cod oil is a derivative of Newfoundland chiefly. It is shipped from Newfoundland to ports of entry in tank steamers and is then transferred to tank cars and shipped

to the tannery, where it is used in the finishing of leather, to make it nice, soft and pliable, to make good leather of [fol. 114] it. Sumac is also used and the best sumac comes from Sicily. It is shipped in the usual way and is made into extract in this country at the tannery. Sumac is a dried leaf shipped in bales or boxes to ports of entry and then shipped to the tannery, where it is reduced to extract form and used in the blending of the other extracts to make good leather.

Those are the chief or more important raw materials that a tanner uses.

I mentioned the method of purchase of the bark and wood. That is spot cash. Quebracho and other imported materials are paid for on usual importers' terms, usually a discount of one per cent, 10 days, or 10/30, or something like that; not sight draft with bill of lading attached, as with hides, or spot cash, the way we do for bark. Of course we do that in North Carolina, because the only reason the mountaineer peels wood and cuts bark is that he needs the money and he gets it, so that we pay spot cash for whatever we get down there.

We have no other sales offices except those located at 39 Frankfort Street, New York City. We have salesmen to represent us and they travel throughout the country selling our products. These salesmen report to the New York office. The entire sales force covers the entire United States; they occasionally go into Canada. Most of our foreign business is done through what we call leather factors in Europe with whom we have been closely associated for many years, and we seldom send salesmen to the other side. The salesmen do not report to Asheville; all salesmen report to New York. Occasionally, though, a salesman on the road finds a customer who is in urgent need of a certain weight or quality of leather and cannot wait for the usual routine. The salesman wires to the tannery if he cannot ship it from New York, and gets instructions back to ship by express, the formal order follows the usual routine. It is sent to New York, from New York to Asheville, and from Asheville returned to New York showing that it has been shipped to the customer on such and such a date, and the bill is made out here.

[fol. 115] All salesmen have a standard printed form of order blank in triplicate. They visit a prospective cus-

tomer and ascertain his wants, his needs; they agree upon what he is to get and make out this order in triplicate and give the customer the original; they send duplicates to New York; they send the triplicate to Asheville in case the shipment is to be made from there, but it is not made on that customer's sales memorandum. The shipment is only made on the direct order which comes from New York, but the sending of a triplicate to the tannery often facilitates getting out something that we have not on hand. It gives them perhaps two or three days' or a week's leeway before the real order comes through from New York.

Any order at all that can be filled from New York is filled from the New York warehouse first. As I said earlier in my testimony, the tannery is the manufacturing plant and is the reserve storehouse. We keep a large quantity of leather here, a good many hundreds of thousands of dollars worth here in New York all the time and, as far as we can, we anticipate the requirements of our customers and ship from here. If we are short some particular weight or grade of leather here, we send a requisition order to the tannery to ship that leather in one of the carloads that is coming every few days to New York and, when it comes here, we either put it in stock or ship it to the customer, as the case may be.

We do not sell the hides which we tan in an entire piece. We cut the hide up into a multiplicity of pieces. (Witness refers to chart.) In the first place, we take off the bellies, the legs of the animal, then we take off the head, then we take off what we call the shoulder, that is the upper forepart of the animal. That is in accordance with usual tannery practice; I mean other tanneries of heavy leather do the same thing. They all cut the bellies, shoulders and heads off.

We go a number of steps further. We take the center portion of the back, which is the best part of the back, which has the best fiber, and so on. We cut that into a mul- [fol. 116] tiplicity of pieces in accordance with the purpose for which that particular piece of the hide as leather is best suited, which is the back bone section. These and the side pieces, the second cut shoulder there and the rough shoulder there. These are the bellies, the shoulder and the tail.

In cutting up this part of the hide, here is where we differentiate from any other tanner, so far as I know, in

the country. We take that part of the hide and cut it up into various sized strips, side strips and so on, finish it in various ways so that it is practically ready for the belt manufacturer to make it into a belt, a six inch belt or 24 inch belt, or even a 48 inch belt; he can get the leather cut by us just as he requires it. It has been found very advantageous to the average belt manufacturer to buy that way rather than to buy a whole butt in the rough and either curry it and finish it himself, cut it up himself, or have it done by some contractor. For that reason, he has a minimum of waste in making a given belt. If he wants to make a 16 inch center belt, for instance, we send them a 16 inch center, or a number of them, and all he has to do is to even off the butt end, the shoulder end, and scrape it so that when he laps it, it makes an even surface all the way through. That is all he has to do. He has no waste. If he should buy that whole part of the hide there in rough, then begin to strip it up and curry it, he would have a good many pieces there that would be strips that he could not use in his own making of belts, and he would have to sell them at a very low price to a scrap man, and that counts up considerably.

So that this particular Company has established a very wide business throughout the country with the belt manufacturers in that line, specializing in curried, finished, belting leather. It saves them a lot of money; they can get just what they want and no more, and it minimizes the amount of labor that has to be put on a belt, the amount of time, the amount of overhead and expense, and they find it to their advantage to buy that way. Most heavy leather tanneries sell their hides cut into four parts; that is, two bellies, the head; that makes three parts, and a rough butt, [fol. 117] which takes in this section in here (indicating). All of this nice, squared up part is sold as in the rough. Then the man that buys it that way has to cut it up, finish it and fabricate it into whatever he is going to make out of it.

The invoices for our sales are made out in New York. No invoices are made in Asheville. Asheville gets its orders from New York. They fill the order the best they can. We have, of course, printed forms showing shipments, and they put on the printed form the number of pieces, the weight and grade and all the particulars that are neces-

sary, and the routing, stating that they have shipped against New York order number so and so, to John Smith or somebody else, and that they send to New York the day that the shipment goes forward or the day that they made it up. As soon as that is received in New York, the accounting department in New York makes up the bill and sends it to the customer. All bills go to customers from New York. All receipts come from customers to New York. Asheville is only a manufacturing plant.

All prices are determined in the New York office by the head of the sales department; the vice-president in charge of the sales department, Mr. McKown.

Some of the petitioner's manufacturing processes is carried on outside of the State of North Carolina. For instance, we always have done a great deal of manufacturing in New York. Up to within a few years ago, we had a large manufacturing plant over on Hague Street, just under the Brooklyn Bridge, besides the cutting rooms and the manufacturing plant we have here in this building. We do a good deal of finishing here, notably strapping for, for instance, the International Harvester Company, for the reapers and binders and harvesting machinery. We make visors and what are called keystones for miners' caps; we make pretty nearly all that are made for the miners in the United States. They go to the cap manufacturers who add a small linen or cotton cap to it. The keystone is the thing they stick the light in, in the front, and the visors we [fol. 118] make. We make all kinds of hydraulic packing leathers; for instance, for the Otis Elevator Company; all the big elevator people, who buy it for their elevators. We make all sorts of disks for the Standard Oil Company and people of that kind, washers for valves, and a thousand and one different things. This manufacturing I have just described is all done in New York.

The petitioner does not make any profit on its sales of the bellies and heads of the hides which it sells. To a novice in the leather game it seems rather extraordinary that a tanner will make hundreds of thousands of pounds of leather a year but he does not make any money on them, but it is a fact and it is easily explainable because that whole hide is bought as a hide; we have to buy them that way. We buy the hide, those bellies and so on, and the tail,

as part of the hide. We pay a flat price for that hide. Today, for the sake of argument, we pay about 25 cents a pound. We pay 25 cents for the head; we pay 25 cents for the tail; we pay 25 cents for the back part of the hide, which is worth money. To give you an example as to why we do not make any money, by the time the snouts are trimmed off, the ears are trimmed out, the eyes are trimmed out, and all the flesh that comes around the lips is pared off, there is very little left that will make leather. Out of 100 pounds of heads, we make about 40 pounds of leather, so that with 40 pounds of leather, with no betterments added, that is the tanning or anything else put on it, 40 per cent out of 100 pounds costs you, as the cost of the leather, about 60 cents a pound for something that you have paid 25 for.

Now, the average head today, as leather, sells for 20 cents, so that you see that there is nothing in that. It is an economic waste of those kinds of things to throw those heads away. In the old days we threw away lots of things in all industries that we do not throw away today. Today the industry that does the best is the one that operates with the greatest economy, reduces waste to a minimum, and we try to do it.

[fol. 119] We find a market for tails. It is true we pay 25 cents for tails as a part of the hide and we get perhaps 5 or 6 for them, but we save them just the same.

That same line of reasoning applies to the bellies but not to as great an extent, because the bellies sell for a little more. They sell for about 36 cents, so that we make about 50 per cent on the belly; I say 50 per cent, that is, we make 50 pounds of belly leather out of 100 pounds of green salted bellies as they come to us on the hide. As an evidence of that, today a great many tanners, because of the high priced hides, are having the bellies and heads and sometimes the shoulders cut off in the packers' cellars, and they are sold either for glue stock at a cent or two a pound or for other purposes, because the tanner feels that he cannot afford to make them into leather and stand the loss on them.

We are familiar with the selling price of butts obtained by other tanners in the country. We are in close touch with the markets, not alone in this country but of the world, every day. The prices we receive for the butts, in the form

that we finish them, is very much in excess of the prices that the average heavy leather tannery gets for butts in the rough. That is for the reason that we bring out butts, as we call them, more nearly to the finished product. We separate, strip out, denude all of its flesh and so on, and cut it into the strips that a belt maker requires, curry it and finish it, and practically all the belt maker has to do is to glue it together and he has a belt. That is the reason we get more, and as I said a moment ago, a belt man who buys our finished leather saves very largely on the amount of capital outlay, the amount of time and labor, and one of the most important features with him is that it economizes his waste, which is a large factor as a rule. As you can see, a man who buys a whole hide has only a very small portion of it that can go into higher grade belting; he has to find a market for the lower grade articles.

Our profits are dependent on three primary factors: the first one and, I would say, the most important, one of the [fol. 120] two most important, is the care and knowledge that is displayed in the purchase of raw materials, particularly hides. A man has to be well versed in that game to make good, the same way as a man has to be a pretty skillful operator in Wall Street to keep his head above water. The buying of hides is a very speculative game. Prices of hides are quoted differently and they fluctuate almost as rapidly and as markedly as the prices of stocks do in the stock market; so that you have to be thoroughly in touch with the markets of the world all of the time to be able to buy advantageously, so that at the end of a given period, either six months or a year, your purchases have either been low or not higher than the average market.

That is the first and most important branch. The second branch, which is of less importance, is the question of labor in producing the leather at the tannery. In the leather business, the labor item is not of as great importance as it is in a great many other instances, for the reason that a little labor goes a great way in the tannery and against the number of pounds of production, the unit of labor is one of the smaller items.

Of course the cost of the hides comes first; that is your biggest item. Then the extracts that you put into it come next; overhead, and so on. But your labor is not as much

of a factor as it is in other industries and, for that reason, it is not as important. Of course all labor is important and has to be kept down within reason.

A third and equally important factor with the first factor is the method and the manner of merchandising the leather. With us, that has been a gradual development over a great many years in the manipulating and development of certain markets throughout the country in this cutting up of the leather and operating through these individual belt makers all over the country. That is equally important to the ability of buying hides right, the merchandising of the leather and the manipulation of it for the purpose of merchandising it in the particular way that we sell it.

[fol. 121] The petitioner sells the bellies and heads in wholesale quantities. That is part of what we call our wholesale business. The bellies, heads and shoulders are sold, as a rule, in carload lots to—well, the bellies go to shoe manufacturers for the manufacture of counters, insoles, heel taps, and so on; the shoulders go to the welter, who makes the welting, which is the welt on the shoe; the head goes to the shoe manufacturer also; they build up the women's heels, very little comes from the head, because you see you cannot get very much of a piece of leather out of a head, and they have to cut small pieces out of them. But that class of stock is all sold in carload lots and is considered our merchandise leather, or our wholesale business.

Those portions of the hide are sold by us in a similar manner to the way other heavy leather tanners sell their offal, as they call it, that is the bellies, shoulders and heads.

We are familiar with prices received by other tanneries of the country. Our costs are often in excess of the selling price of other tanneries, for the reason that we specialize as we do in cutting up the leather into a multiplicity of pieces and finishing it in various ways, so that the buyer can get the most out of it with a minimum of waste. We, in a way, stand that waste, because we throw it into the other parts of the hide, and that saves a customer from buying anything but what he can use to good advantage.

It will cost us more to make leather today than you can buy it for. That is demonstrated very clearly by the fact that a number of belting manufacturers and belting leather tanners have reduced their working in of hides in their own

tanneries and are buying leather on the open market, both from other tanners and from competitors, because they can buy it cheaper than they can make it.

The petitioner has gone into the market and purchased rough butts already tanned. In very large quantities the last year we did that, I think, was in 1919, when we bought [fol. 122] very largely of other people's rough leather and finished it and sold it, as we sell our own leather. We did that because the price that we had to pay for the purchased leather was so much less than the cost of our own leather at that particular time, that there was very considerable increase in margin in the merchandising of that belt leather than there would have been had we sold our own. That goes on all the time. It keeps the manufacturing manager up to time, too. If you tell him, "We will shut down your plant because we can buy leather cheaper than you can make it," that makes him stand up and get busy.

All tanners buy their hides whole, but none of them tan them and finish them the same way that we do, in that we carry it from the green salted hide condition right up to the finished belting strips, right straight through. No other tanner does that that I know of.

The majority of tanners purchase the green hides outright, as the petitioner does, if they have the money. Those that have met with misfortune, as some of them have, due to the troubles that we have had just after the Armistice, where there was an over-supply of leather in the country—a great many of them have been in the hands of the banks and so on and have not had the capital to swing their business. And some of them buy on what they call a domestic letter of credit. That is, they arrange with the bank to finance their purchases of raw materials and that domestic letter of credit carries with it the ownership of materials bought under that letter of credit, and is retained by the bank of issue until such time as the buyer has paid the amount of the letter of credit. Others, who have not enough money to operate their plants, tan on what they call a tanning contract. A tanning contract is a contract entered into between a tanner and an owner of raw materials, or sometimes a packer. If the packer can not sell his hides to advantage, he will send them to a tanner to be tanned for him, at so much a pound and, in that case, of course the

ownership of the hides is retained throughout by the man [fol. 123] who sent them to the tanner to be tanned. The tanner gets so much a pound for the tanning of these hides, f. o. b. the tannery sidetrack, when they are loaded into the car.

In other cases, as those who use a domestic letter of credit, and so forth, the bank owns the finished tanned hide, until it has been reimbursed. And the man on the tanning contract, the man who sends the hides to the tanner, owns them always. He never has relinquished the ownership. It is just an in-transit proposition, just as lumber goes from one mill to another to be sized and sorted, and goes on to another destination, with a service charge in between.

As a rule, over a period of years, the cost of tanning leather on contract is about 12 cents a pound. That includes the bellies, the heads, scoured and rolled leather that goes to the shoe manufacturer, just as we get out ours.

During the years involved in this proceeding—1923, 1924, 1925 and 1926—the petitioner could have had hides tanned by another tanner under one of these contracts. We have even been solicited to tan. Swift and Company, a few years ago, were very anxious for us to tan in large quantities for them, but it is a game few tanners get into if they can swing their own business.

Considering these prices that were charged in the tanning contracts, the profit or loss of the petitioner under its tanning operations could be calculated. It would be, of course, more or less of an estimate, but it could be calculated. In our tannery, we know what our costs are periodically. Every six months and every year, we know our exact costs of production. We know that a tanning contract can be let at a certain stipulated price which, on an average over a period of years, has been about 12 cents. In order to compute the difference between our costs and what it would cost if we tanned a given amount of leather on a contract, it would be the difference between our cost and tanning contract price, multiplied by the number of pounds of leather for the period in question.

[fol. 124] Where a tanner sells the entire hide, as some tanners do, their business is generally considered a wholesale business. Where a tanner cuts up the hide and sells it, as the petitioner does, that is considered retail, because,

in the wholsesale business, most everything is sold in carload lots, and in the retail business it is never sold in carload lots. It goes from a few thousand pounds down to two or three pounds, and may be shipped by parcel post. That is the difference between the wholesale and retail.

In the tanning industry generally, it takes from four to six months to convert a green hide into finished leather, approximately. The market price of green hides fluctuates constantly, from day to day. The further away you get from the raw material, the less the fluctuation and the more difficult it is to advance your prices. I think, on the average market, the prices the petitioner pays for green hides compared with the average market prices for green hides, is lower. It is due possibly to a little good luck and a little good judgment; a combination of both. So far as I know, the petitioner has complied with the provisions of the law of North Carolina, authorizing it to do business within the State of North Carolina. We have always paid all taxes assessed against us; some years under protest. Outside of the income tax which is in dispute, we pay the foreign corporation income tax, which is under dispute now, the State and city franchise taxes; that is three. Then we pay the county and city property taxes; five taxes, I think. Of course then we pay the taxes on our mountain lands besides, but that is a property tax. It comes under the head of county taxes.

Cross-examination.

By Mr. Siler:

We operate one tannery and it is located at Asheville, North Carolina. It was the only one we were operating during the years that the tax, now in discussion, is in question. We have operated this tannery since 1898. The [fol. 125] office, from which our business is transacted, has always been in New York. We have three salesmen; they cover the entire United States. Any sales made in Continental Europe, Great Britain, Canada, or other sections of the world, are usually handled through factors on the other side, or through agents in this country, and so on. Whatever they sell of our product either comes from Asheville to New York, or else it is purchased by us on the market.

As stated, we have a retail business and a wholesale business. The wholesale end is conducted from New York. Most of the shipments are made from the tannery. As to the retail business, a large portion of the shipments are made from New York. Our warehouse in New York is supplied from the tannery at Asheville, with the exception of such outside leathers as we may buy from time to time, in order to replenish certain stock, which we have not got, or, as we have shown here, if we can buy leather cheaper than we can make it, we buy it. In buying hides from packers, the broker acts as our agent. He charges brokerage and we pay it; the packer does not pay any portion of it, that we know of. The cost of the hide, raw, is about 60 per cent of the cost of the raw materials. I should say, the hides, raw, cost about 60 per cent of the total of the finished product.

As a rule we keep a very small amount of supplies in our New York warehouse. When we receive an order, we do not send it to Asheville if it can be filled from here. We do not keep very much wholesale stock in New York, but some of it. We keep a good deal of stock, numbers of hundreds of thousands of dollars of leather in New York.

Mr. Greenough: You asked about supplies in New York, I think originally. I think that is what threw Mr. Rees off.

Mr. Siler:

Q. I meant supplies of leather.

A. I did not understand your question. We consider supplies as bark, wood, oils, greases and things that go to make leather. Our finished product, we call leather, not supplies.

[fol. 126] When our stock in New York gets low, we send a requisition to the tannery at Asheville for the various and sundry grades that we may be short of here, and they embody that in carload lots and ship it to New York.

Our belt leather is finished partially in Asheville and partially in New York. I should say the larger proportion is finished in Asheville, but not necessarily the better grade of leather. Some of the highest priced leather that we finish, we finish here in New York.

In buying the whole hide, we pay a certain price per pound for the entire hide. After cutting it up, one portion

is worth more than another, and another still more. In arriving at our loss or profit on each particular piece of that hide, we base our cost on the original price, regardless of what it costs to prepare that particular piece of leather. When we buy the hide, we know that the head and legs and tails are not worth as much as the middle. But I would not say that we allocate our price the same for the sorry part as we do for the good part. We have to buy a head, yes; a packer won't cut a head off and sell us just what we want. The tanners that I spoke of this morning, who are cutting off the bellies, shoulders and heads and selling it as glue stock, they have to pay 25 cents for that just the same, and sometimes they have to pay the packer for cutting it off.

The heads, legs, etc., cost us 25 cents per pound. We sell heads in the neighborhood of 20 cents. We sell bellies in the neighborhood of 36 cents; shoulders, as high as 60. But you must remember in considering that, that for instance the main part of the hide, the center of the back bone section, there is very little to come off of that, so that you can make a greater number of pounds, per hundred pounds of back bone hide, than you do from the heads. For instance, where there is so much that has to be trimmed off, meat, ears, jaws. It costs us more to tan the head and the tail than it does the back, because of the reduced pounds of leather we get, and we get less for it. In buying hides, we do not figure that the cost of the backbone is any [fol. 127] greater than the cost of the leg or head, because we have to buy hides according to market conditions, and they are all sold whole at a price for the whole hide, according to its quality and character. We would have to pay more for the back if we bought them separately, but you cannot buy them separately. Some tanners sometimes leave the heads and bellies at the packers' places and sell them wholesale for anything they can get for them, but when he goes out to buy them he has to buy the whole hide. If we could buy separate, then the back would cost considerably more than the heads, tails, and so forth.

A tanner must make good leather or he cannot expect to merchandise it at the best market prices. But with proper raw materials, the quality of the leather is not as difficult a problem in the final dollars and cents result, as the careful buying of your raw materials and the merchan-

dising of your finished product. But, as I say, you must make good leather.

The cost of the raw material comes first, and the cost of tanning is somewhat less than the cost of raw materials put into it. But the selling expense is much less than the cost of tanning, including the office overhead and everything. The principal cost of tanning is in materials, and the greatest cost of materials is in hides. At the tannery, aside from the leather, the principal cost is in the extracts we use to make the leather. In these days, we use a combination. As I cited, we use chestnut oak bark, we use chestnut wood and we use quebracho extract, and so on. The one that costs the most today is quebracho; that is, as used in our proportion. We use about 50 per cent quebracho, about 30 per cent chestnut extracts, about 20 per cent bark—that is, roughly speaking.

As stated, by reason of the peculiar way in which we separate our hides, the cost to us is more than to the average tannery, and our sale price is in proportion; more than to the average tannery. We get more for our finished cut up strips than the other man does for his whole rough [fol. 128] butt. We do not do any tanning for other packers or other people. The fluctuation in price of raw hides is continual, from time to time. Hides in the last 12 months have jumped 100 per cent.

It is an impossibility to advance the price of our finished product to keep pace with the advancing prices of raw hides. We try to do it but, as I stated, while it is easy to fluctuate the prices of raw materials, the further away you get from that the more difficult it is. Leather has advanced about 30 to 40 per cent in that period of advancement of 100 per cent in raw materials. Naturally, we try to advance the price of leather, just as the raw man tries to advance his prices, but it is very difficult to do it in our line, for the reason that there are so many of what we call banking tanners in the trade today. They are controlled by the people to whom they owe money. We are familiar with the methods that are in force in most tanneries: The Central Leather Company, DeFord and Company; they are located in Virginia; the Luray, the Covington Company. The Central Leather Company has in operation today some 28 or 30 plants; they had 60 but they have abandoned the most of them. Then take the Armour Leather Company's plant,

at Sylva, North Carolina; I built that and operated it about 14 years ago. Their present methods are pretty much the same as those we established there before we gave it up. I think they are advancing with the times just as we are. They are making good leather. We know their leather; we know about how they tan. We are pretty well familiar with other people's affairs. We are in close touch with them all of the time.

We buy some hides from Knoxville and Bristol, from those abattoirs. There are no local abattoirs in North Carolina that I know of. You see, we cannot buy half a dozen hides here and half a dozen hides there; we cannot buy less than a carload, and there is no local killer in the State of North Carolina that kills anything like 600 cattle a day. So we are able to buy very few hides in North Carolina and, as I say, they do not come from North Carolina.

[fol. 129] EDWARD D. McKOWN, called as a witness on behalf of the petitioner, being duly sworn, testified as follows:

Direct examination.

By Mr. Greenough:

I am the second vice-president and a director of the petitioner, Hans Rees' Sons, Inc. I have charge of the direction of sales and the purchase of hides. The petitioner has salesmen who travel through the country selling to the trade. These salesmen are under my personal supervision, and I am one of them. These salesmen do not report to the Asheville tannery.

Some of the products of the tannery are shipped to the New York warehouse—somewhere between approximately 40 to 50 per cent. Customers, at times, send shipping directions to the tannery, which are generally applied on their open contracts and, if they have no contracts, New York is consulted or informed. However, most of our customers in sending in shipping instructions to the tannery send a duplicate copy of same to us here in New York. Only a very small part of the output of the Asheville tannery is shipped to customers within the State of North Carolina;

without checking it up, I would say less than one-half of 1 per cent.

In general, I am familiar with the prices charged for tanning, in tanning contracts entered into with various tanners. In the year 1923, I do not think there were many contracts made; my recollection is that it was somewhere in the neighborhood of 14 to 15 cents a pound. In 1924, I think they were somewhere in the neighborhood of 12 cents; in 1925, I think between 11 and 13 cents—somewhere in the neighborhood of 12. I think in 1925 they were a little higher than in 1926. I think in 1926, they were between 11 and 13, average about 12.

I would say the outstanding concern of leather manufacturers in this country is the United States Leather Company, which was the Central Leather Company prior to a year and a half ago. They issued statements of their financial condition during the years in question—1923, 1924, 1925 and 1926. The total assets of the Central Leather [fol. 130] Company were $107,271,766.56. It sustained a net loss, for that year, of $5,434,035.44—the year 1923. For 1924, after deducting interest, they report a loss of $484,306.65.

Their statements are rather complicated, and I would have to do some figuring to ascertain their earnings before they deducted the interest. There was a net profit of $1,353,900.85. The records of the Central Leather Company, for the year 1925, show their assets, December 31, 1925, $91,789,050.52. Their profits for that year are stated as $2,548,014.59. The percentage relationship between that figure of profits and the assets of the Company for that year is about 2¾ per cent. The records for 1926, of the Central Leather Company, show their total assets as being $90,118,174.37, and the report shows their net earnings for the year ending December 31, 1926, as $1,494,919.58, or approximately 1.6 per cent of the total assets for that year.

The National Leather Company is another important leather manufacturer. Their financial statement for 1926 shows their total assets for that year as $22,593,388.35. I do not think the total sales of that Company are reported for that year. The report shows a net loss for them, for 1926, of $239,823.43. Their records for the year 1925 show the total assets of their Company for that year to be $25,358,684.50, and their sales for that year are reported as

$25,837,340.88; it shows a net profit of $720,557.53 for the year. The percentage relationship between the assets of the Company for that year and that profit would be approximately 2.8 per cent. That profit is about the same percentage of the sales. The sales and assets were about the same—2.75 per cent about. For the year 1924, the records show the total assets as $28,365,474.67, and the total sales as $26,520,817.81. The report gives its net profit for that year as $951,387.31. The percentage relationship of that profit to the total assets of the Company for that year is approximately 3.4 per cent. The percentage of the profit [fol. 131] to the total sales is approximately 3.6 per cent. For the year 1923, the records of the National Leather Company show their total assets to be $26,316,727.66. Their total sales for that year are not given in this report, and their profits for that year are not given, either gross or net.

Pfister and Vogel Leather Company is another one of the large leather companies. Their financial statement for 1926 shows their total assets as $15,287,816.79. The report does not show whether it made a profit or a loss that year, nor its sales for the year. For 1925, their records show the assets for that year as $17,390,967.76. The report shows an apparent profit of $135,523.92 for that year. Those profits are approximately less than 1 per cent of the assets of the Company; about .8 of 1 per cent.

Cross-examination.

By Mr. Siler:

These figures that I have given from these different companies are taken from their financial statements as appear in a trade publication. I have no personal knowledge as to the correctness of those facts other than that they appear in the books.

The petitioner has three salesmen; three including myself. Between 40 and 50 per cent of the output of the plant at Asheville is shipped from the Asheville tannery to New York. The other 60 per cent is shipped direct on orders from New York. The customer sends his order to New York, and we direct from where it is to be shipped. Shipment is made direct from Asheville to the customer. There have been instances, when a salesman on the road sells a bill of belting and wants immediate shipment, that he

would send the order to Asheville and have it shipped immediately, without either telegraphing or telephoning New York.

The principal sales of the National Leather Company are derived from the manufacture of leather. I do not know what their total sales were for the year 1923 of leather other. [fol. 132] than from the records referred to. I do not know what hemlock lumber and hardwood lumber were worth per foot or per hundred. I do not know how the sales of 127,000,000 feet of hardwood timber would compare with the sale of 5,000,000 hides. I assume that their sales and profit and loss for the year are based not alone upon the sale of leather, but the sale of lumber also, in 1923, 1924 and 1925; that the statement of their entire business showed the net results. I do not think in 1923 that I gave the sales, nor do I think that I gave the sales in 1924. I am not positive as to the value, in 1925, of lumber, of 152,000,000 feet plus of hemlock and hardwood timber. I assume the profit includes the profit on the sales of the timber. I would assume that the profit and loss, as stated at the close of each of those years, included the profit and loss from the sale of this timber.

EDITH F. GORDON, called as a witness on behalf of the petitioner, being duly sworn, testified as follows:

Direct examination.

By Mr. Greenough:

I am an officer of the petitioner, Hans Rees' Sons, Inc., holding the office of Secretary and Treasurer. I have been Secretary and Treasurer for three years and assistant Treasurer, previous to that, for a little over two years. I have been in the employ of the petitioner about 13 years. Before becoming Assistant Treasurer, I was Secretary to the President and Chairman of the Corporation. I took care of Mr. Rees' personal correspondence, as well as any correspondence he might have had, and worked up statistical data for directors' and stockholders' meetings, figured on inventories, took care of the hide invoices, saw that they were invoiced properly to the tannery, and checked any other bills which might have come in, took the place of the

bookkeeper when she was on her vacation, made entries on the cash journal, took in money and deposited it, etc. I took a course in accountancy at Pace and Pace's School of Accounting. As Treasurer of the Company, I have charge [fol. 133] of such of the Company's books as are in the main office in New York. We have in the New York office a sales book, sales ledger, general ledger, purchase ledger, cash journal, journal, insurance ledger, hide invoice book, inventory folders, profit and loss ledger, profit and loss statements and asset and liability statements.

The sales book contains a complete copy of all invoices sent to customers, divided up into departments, such as curried department, which is known as retail, and belly, shoulders and heads, in the merchandise, which is known as the wholesale department. They also have a walrus department and a by-products department. The sales books are totaled to get the amount of sales, by days.

The sales ledger contains entries from the sales books, which give the name and address of the customer, the date of the shipment or the date of the invoice, the terms of the sale, and the total amount of the invoice.

The general ledger is composed of the assets and liabilities of the Company, such accounts as the land account, the bills receivable, accounts receivable, and the total of the sales books by months, the expenses in total by months, and so on.

The purchase ledger is composed of accounts showing such purchases as cod oil, hides at the tannery, and miscellaneous supplies. This book shows the name of the party we had goods from.

The cash journal is composed of entries showing cash received and cash paid out. The cash receipts consist mostly of checks from customers for leather shipped them and payments composed of dividends, salaries, payment of drafts for hides for the tannery, some supplies for the tannery, mostly the larger purchases, and so on.

The journal is composed of closing entries of the books and all entries not made in the cash journal.

The insurance ledger shows the amount of insurance we carried on each risk. It gives the names of the insurance companies and the amounts.

[fol. 134] The hide invoice book shows all of the hide purchases made for the account of the tannery.

The inventory folders show the inventories in New York and also in Asheville. The physical inventories in New York are taken every three months and book inventories are taken once a month. The Asheville physical inventories are taken every six months.

The private ledger is composed of such accounts as capital stock, profit and loss, such accounts as the officers' and employees' savings accounts, and so on.

The profit and loss statements and the asset and liability statements are made up by auditors every six months. I make up the profit and loss and asset and liability statements every month.

That is all I have on my list.

Those books over there on that table are the various books I have referred to. The large books are the sales books, approximately 25 by 18 and 2 inches thick. The book on the top is also a sales book. We have condensed our sales book to that small size on the top. There are 8 large sales books and one small sales book. There is also a general ledger and a purchase ledger and a paid bill book for leather and a hide invoice book, and the inventory folders for the years in question. All the entries in these books named are made by me or under my personal supervision.

The petitioner has accounts with seven banks—two in Asheville, North Carolina, and five in New York. The New York banks are the Chemical National Bank, the National Bank of Commerce, the National Park Bank and two branches of the American Exchange—Irving Trust Company. The two banks in Asheville are the Central Bank and Trust Company and the Wachovia Bank and Trust Company. We have two accounts in the Central Bank and Trust Company known as the New York account and the Asheville account. We carry an average balance on the New York banks from $50,000 to $100,000, and in [fol. 135] the Asheville banks on an average of $1,000 each. The Asheville account in the Central Bank and Trust Company, the present average is from $2,000 to $3,000.

Checks drawn on the New York account consist mostly of amounts sent to the tannery to cover the freight bills on hides and the payroll and any miscellaneous expense which they may have. The tannery deposits this check we send

them into their Asheville account, and payments for those things are made from that account. From the New York account, we pay for hides shipped to the tannery, dividends, payroll, officers' salaries, all miscellaneous supplies for New York, and some supplies for Asheville, such as cod oil, by the car, quebracho by the car, and so on.

I know that the petitioner purchased a considerable amount of tanned butts during the year 1919. I keep a record of these purchases. I had charge of the bills when they came in and saw that entries were made on the purchase ledger and pasted the paid bill in a paid leather bill book. The purchase ledger is over there. (Indicating.) I have compiled from these 1919 leather purchase records the total number of pounds of tanned butts purchased by the petitioner and the total cost paid for them. We purchased 355,488 pounds at a value of $328,278.14. By calculating the average price per pound paid for these butts, I found it to be 92,34 cents per pound. This price does not include the cost of currying. It was necessary to ship the rough butts to Asheville to be finished and curried and cut into such parts as our customers needed, such as centers, side pieces, shoulders, and so on. It cost us 7.31 cents per pound to curry leather in 1919.

The total cost per pound of this leather which was purchased by the petitioner in 1919, when curried and finished ready for sale was 99.65 cents per pound. In the year 1919, we sold 1,885,568 pounds of curried leather. We received $2,298,677.02 for that leather. The average price per pound received for that leather in that year was 121.91 cents per pound. I arrive at that figure by dividing the weight of the curried leather sold, into the value. We fig- [fol. 136] ured a profit of 22.26 cents per pound on leather which was purchased in the rough butts in 1919 and sold as curried leather. To calculate that, I took the cost of rough butts purchased of 92.34 cents per pound and added the cost of currying for that year, 7.31 cents per pound, and had a total cost of 99.65 cents per pound. I deducted this from the price received, 121.91 cents per pound, and that shows a profit of 22.26 cents per pound. Our manufacturing costs for butts was 108.34 cents per pound during the year 1919. The petitioner's profit per pound on the curried butts which it tanned at its own tannery and sold

during the year 1919 was 13.57 cents per pound. I arrived at this figure by deducting the cost of manufacturing the butts, 108.34 cents per pound, from the price received, or 121.91 cents per pound, or an estimated profit of 13.57 cents per pound.

The Shoe and Leather Reporter is considered a good authoritative publication setting forth the market price of leather. It is published once a week. It was published during the years 1923, 1924, 1925 and 1926, and the petitioner was a subscriber of that publication during that period. The weekly issues state the market prices of bellies, heads, shoulders and butts for each week. The Shoe and Leather Reporter is looked upon in the trade as a good authority, the same as stock exchange quotations in daily newspapers are looked to for prices. A leather tanner or manufacturer controls and operates his business in view of those quotations.

I have calculated the average market price per pound for bellies during the year 1926 and found it to be 27 cents. I have calculated the average market price for heads during the year 1926 and found it to be 16 cents. Our records are shown on the sales book and from the sales book I had all the sales of the bellies added together, by piece, weight and value, and divided the total weight into the value to get the average price. The values are listed in the eight large books I referred to.

We sold 1,246,754 pounds of bellies during the year 1926, and we received $330,112.33 for these bellies, making an [fol. 137] average price per pound received for these bellies of 26.48 cents. To calculate that, I divided the total weight into the total value received.

The average price received for heads by the petitioner during 1926 was 14.61 cents per pound, and our total sales of heads for that year was 301,588 pounds. The total price received for these heads was $44,059.66. The 14.61 cents was arrived at by dividing the weight into that total value of $44,059.66.

The average market price for bellies for the year 1925 was 24.5 cents per pound. The average market price for heads during the year 1925 was 15 cents. The average price received by the petitioner for bellies during the year 1925 was 23.02 cents per pound. I arrived at that figure

by dividing the total weight of bellies sold into the total value received. The total weight of bellies for that year was 1,264,518 pounds, and the total price received by the petitioner for those was $291,077.01.

I have calculated the average price per pound received by the petitioner for heads during the year 1925. It was 12.19 cents per pound. I found the total weight of heads sold by the petitioner during that year was 304,786 pounds, and the total amount received for those was $37,147.28. I arrived at that average of 12.19 cents per pound by dividing the former figure into the latter.

I have calculated the average market price for bellies for the year 1924—20.75 cents per pound.

These average market prices I have referred to, both in 1926 and 1925, and now in 1924, were taken from the Shoe and Leather Reporter.

I have calculated the average price for heads for 1924. It is 12.5 cents per pound. I have calculated the average price received by the petitioner for bellies for the year 1924 to be 19.17 cents per pound. I arrived at that figure by the same method previously described. I found the total weight of the bellies sold by petitioner during the year 1924 to be 1,254,417 pounds, and the total value $240,590.15.

[fol. 138] I have calculated the average price received by petitioner per pound for heads during the year 1924—we received 9.6 cents per pound. The total weight of the heads sold by petitioner during that year was 207,201 pounds, at a value of $19,924.92. I arrived at the average figure of 9.6 cents per pound by dividing the former into the latter figure.

I have calculated the average market price for bellies during the year 1923; 24 cents, and the average market price for heads for the same year is 13 cents per pound. These two average prices just referred to were taken from the Shoe and Leather Reporter.

The petitioner received 19.95 cents per pound—average price per pound—in 1923 for bellies. I arrived at that figure by dividing the total weight into the total amount received for bellies for that year. The total weight of bellies sold was 1,431,522 pounds at a total value of $285,577.31.

I have calculated the average price per pound received by petitioner for heads during the year 1923. We received 10.34 cents per pound. The total weight of the heads sold for that year was 293,349 pounds, at a total value of $30,329.72. I divided the former figure into the latter to arrive at that figure of 10.34 cents per pound.

I have calculated the average market selling price for butts for the year 1926; it was 55.866 cents. To arrive at this figure, I took figures of No. 1, No. 2 and No. 3 butts from the Shoe and Leather Reporter. I added the average price for each month and divided by 12, and had an average price of 59.583 cents for No. 1 butts. I added the average price by months for the No. 2 butts and had an average of 57.25 cents. I also did the same with the No. 3 butts and had an average price of 53.5 cents per pound.

Our experience has shown us that the hide produces 5 per cent. No. 1 leather, 55 per cent No. 2 leather, and 40 per cent No. 3 leather. I therefore took the 5 per cent of No. 1 price, or 2.979 cents, and 55 per cent of the No. 2 butt price, or 31.487 cents, and 40 per cent of the No. 3 price, or [fol. 139] 21.4 cents. Adding these average prices together for No. 1, No. 2 and No. 3 classifications, I had an average price per pound of butts of 55.866 cents.

The petitioner did not sell its butts during the year 1926 as an entire butt. We cut the hides up into centers, side pieces and shoulders and sold them to our customers as they needed them. I have calculated the average price we received for butts during the year 1926 and find we received 67.943 cents per pound. To arrive at that average price, I had all the centers, side pieces, shoulders and butts added and it disclosed that we had sold 127,779 curried centers, a total weight of 489,377 pounds, at a value of $462,296.07; also that we had sold 178,533 curried side pieces, a weight of 837,854 pounds, a value of $639,528.93; that we had also sold 153,073 rough shoulders, total weight 1,025,424 pounds at a value of $371,374.46; that we had sold 13,029 curried butts at a total weight of 186,766 pounds, at a value of $155,672.26.

In order to arrive at a basis of calculation, I found the average weight and the average price of each kind, the centers averaged 3.83 pounds, average value 94.47 cents; the side pieces averaged in weight 4.69 pounds at an aver-

age value of 76.33 cents; the shoulders averaged in weight 6.7 pounds, an average value of 36.22 cents.

I found that we had sold more side pieces than centers but, as a butt is cut up into one center, two side pieces and one shoulder, I took the number of side pieces as a basis of calculation. Taking the 178,533 side pieces at a weight of 837,854 pounds, a value of $639,528.93, and taking one-half of the number of those side pieces, as one center equals two side pieces, I had the number of centers—89,267.

Multiplying the average weight of the centers sold that year by the number of pieces, I had a weight of 341,893 pounds. Multiplying this weight by the average price per pound of 94.47 cents, I had a total value of $322,986.32.

Taking an equal number of shoulders or 89,267 and multiplying this by the average weight of shoulders sold that [fol. 140] year, of 6.7, I had a total weight of 598,089 pounds. Multiplying this weight by the average price received of 36.22 cents, I had a total value of $216,627.84.

Adding to these figures the number of butts sold in the whole of 13,029 pieces of curried butts, a total weight of 186,766 pounds and a value of $155,672.26, I had a total weight of 1,964,602 pounds and a total value of $1,334,-815.35. Dividing the total weight into the total value received, I had an average price of 67.943 cents per pound.

I have calculated the average price to the petitioner of finishing and cutting up the butts sold in 1926. It cost us 6.052 cents to curry the whole butt with the shoulder. To arrive at that figure, I took the total pounds of curried leather sold, of 2,214,480 pounds, I added to it the pounds of shoulders sold, of 1,025,424 pounds, and had a total weight of butts sold for that year of 3,239,904 pounds.

In order to arrive at a basis, I took the total weight of curried leather of 2,214,480 and multiplied it by 8.86 cents, which was the cost of currying leather for that year. Multiplying this by the total pounds of curried leather, I have a total expense of $196,202.93. Dividing the total weight of what we consider the butts, of 3,239,904 pounds, into the total expense of $196,202.93, we have a cost of currying the butts with the shoulder of 6.052 cents.

According to my calculations, the petitioner obtained a higher price for the butts which it sold, cut up into various

pieces, than it would have received if it had sold those butts entire, in the rough, at the prevailing market price. We received 12.0765 cents more. But from this should be deducted the cost of currying the butt, of 6.052, which would give an estimated profit per pound of 6.025 cents.

We sold 3,239,904 pounds of curried butts with the shoulder during the year 1926. The petitioner received $195,204.22 more on these entire sales in 1926 for butts by its peculiar specialized method of merchandising than it would have received for these butts had it sold them in the rough [fol. 141] at the prevailing market price. I arrive at that figure by multiplying the estimated profit per pound of 6.025 cents by the number of pounds of butts sold, 3,239,904 pounds. This figure of $195,204.22 just mentioned compared with the petitioner's actual net total profits for that year shows a difference of about $40,000. The petitioner's actual profits for that year are $155,022.97. To account for that difference, it would appear that our manufacturing operations were conducted at a loss.

I have calculated the average market selling price for butts for the year 1925 and found it to be 57.666 cents per pound. I arrive at that figure by the same method of calculation described with regard to the average market price for 1926. I have calculated the average price that the petitioner received for butts for the year 1925, and found it to be 68.45 cents per pound. I arrived at that figure by the same method of calculation described with reference to the figure for 1926.

It is hereby stipulated and agreed by and between the parties hereto that if the witness were examined in detail as to her calculations of estimated profit from sales for the year 1925, she would testify to the following figures and to the following calculation:

1925 Sales

111,374 Cd. Centers	wgt.	430,581	Value	$415,189.34
Avg. wgt. 3.87			Avg. pr. 96.42c.	
168,650 Cd. Side Pieces	wgt.	812,458	Value	$629,461.54
Avg. wgt. 4.82			Avg. pr. 77.48c.	
Cured Butts, 19,437	wgt.	259,868	Value	$212,391.09
Rgh. Shoulders, 149,128	wgt.	1,059,240	Value	$372,888.24
Avg. wgt. 7.10			Avg. pr. 35.21c.	

[fol. 142] 168,650 Side Pieces	812,458	629,461.54
84,325 Centers x 3.87	326,338 x 96.42c.	314,655.10
84,325 Shoulders x 7.10	598,707 x 35.21c.	210,804.74
19,437 Butts	259,868	212,391.09
	1,997,371	1,367,312.47
	equal avg. pr. of 68.45c.	

Hans Rees' Sons Butt Price	68.45c.
Market Butt Price	57.666
	10.79
	5.455 Cost of Currying
	5.33 Est. profit per pound

We sold 3,134,445 pounds Butts
5.33

$167,065.92

This calculated profit of $167,065.92, as compared with the petitioner's actual profits for the year 1925, shows a difference of $33,600.34. Our actual net profit for that year was $133,465.58. Accounting for this difference, these figures would indicate that our manufacturing operations were conducted at a loss.

I have calculated the average market selling price for butts for 1924, and found it was 55.25 cents per pound. I arrived at that figure by the same method of calculation I have described with reference to the average market price figure for 1926.

I have calculated the average price that the petitioner received for butts during the year 1924, and found it to be 68.96 cents per pound. In arriving at this figure, I used the same method of calculation I have described with reference to my calculation for 1926.

[fol. 143] It is hereby stipulated and agreed by and between the parties hereto that if the witness were examined in detail as to her calculations of estimated profit from sales for the year 1924, she would testify to the following figures and to the following calculation:

1924 Sales

103,611 Cd. Centers	wgt. 406,502	Value		$409,041.16
Avg. wgt. 3.92		Avg. pr. 100.62.		
160,173 Cd. side pieces	wgt. 758,841			608,782.47
Avg. wgt. 4.74		Avg. pr. 80.22.		
21,894 Cd. Butts	wgt. 313,846			261,493.16
130,935 Rgh. Shoulders	wgt. 962,917			287,814.26
Avg. wgt. 7.35		Avg. pr. 29.89.		

160,173 Cd. side pieces	758,841		689,782.47
80,087 Cd. centers x 3.92	313,941	x 100.62	315,887.47
80,087 Rgh. Shoulders x 7.35	588,639	x 29.89	175,944.20
21,894 Cd. Butts	313,846		261,493.16
	1,975,267		1,362,107.30

Equal avg. pr. of 68.96c.

Hans Rees' Sons Butt Price ..... 68.96c.
Market Butt Price 55.25

13.71
Deduct 4.953 Cost Currying Leather.

8.757 Est. Profit per pound.

We sold 2,888,785 pounds butts.
8.757c.

$252,970.90

[fol. 144] The calculated net profit of $252,970.90, as compared with the petitioner's actual profit for that year, shows a difference of $6,041.49, as our actual net profit was $246,929.41. This difference is accounted for by the same reason, that it would indicate that our manufactured operations were conducted at a loss.

I have calculated the average market price for butts for the year 1923. I find it was 67.521 cents per pound. I arrived at that figure by the same method of calculation described with reference to the figures for 1926.

I have calculated the average price per pound received by the petitioner for butts for the year 1923 and found it to be 78.33 cents per pound. I arrived at that figure by the same method of calculation described for the year 1926.

It is hereby stipulated and agreed by and between the parties hereto that if the witness were examined in detail as to her calculations of estimated profit from sales for the year 1923, she would testify to the following figures and to the following calculation:

1923 Sales

114,068 Centers Cd.	Wgt.	458,971 lbs.	Value	$496,910.60
Avg. wgt. 4.02			Avg. pr.	108.27c.
181,009 Side Pcs. Cd.	Wgt.	888,990 lbs.	Value	$839,560.72
Avg. wgt. 4.91			Avg. pr.	94.44c.
17,326 Cd. Butts	Wgt.	221,917 lbs.		$218,683.07
144,508 Rgh. Shoulders	Wgt.	1,015,035 lbs.		$320,810.10
Avg. wgt. 7.024 lbs.				31.61c.
181,009 Cd. Side Pcs.	Wgt.	888,990 lbs.		$839,560.72

90,505 Cd. Centers x 4.02	363,830 x	108.27	$393,918.74
90,505 Rgh. Shldrs. x 7.024	635,707 x	31.61	$200,946.98
17,326 Cd. Butts	221,917		$218,683.07
	2,110,444		$1,653,109.51

Equal avg. pr. of 78.33c.

[fol. 145] Hans Rees' Sons butt price	78.33
Market butt price	67.521
	10.81
Deduct cost currying leather	4.718
	6.091 net. profit per pound

We sold 3,033,933 pounds butts.
6.091c.

$184,796.70

The calculated net profit of $184,796.70, as compared with the petitioner's actual profits for that year, shows a difference of $45,938.87, as our actual net profit was $230,-735.57.

The total wholesale sales for 1926 were $671,800.16, and our gross profits on these sales were $35,782.30. I have calculated the percentage relationship between the total merchandise sales and the gross profit and found it to be 5.32 per cent.

These figures of $671,800.16 and $35,782.30 appear on the records of the petitioner.

The petitioner's total retail sales for 1926 amounted to $1,676,776.75, and the total gross profits upon those sales for that year were $133,468.60. This total profit is 8 per cent of the total sales.

The average market price for butts for the year 1926 was 55.866 cents. The total sales in pounds of butts sold by the petitioner during the year 1926 was 3,239,904 pounds. During the year 1926, the petitioner would have saved $195,-204.22 if it had purchased the butts which it sold in the open market at the average market price instead of tanning the leather at its own tannery. The actual gross profits from the sales for 1926 on its retail business were $61,735.62

less than the profits would have been had the petitioner purchased these butts in the open market. I have calculated [fol. 146] that and have it right here. It is the difference between the estimated profit of $195,204.22 and our retail profit of $133,468.60. This figure of $195,204.22, which I have just mentioned, is the figure I have described the calculation of earlier in my testimony with reference to the 1926 figures.

The petitioner's total merchandise or wholesale sales for the year 1925 were $705,590.31. The gross profits upon those merchandise or wholesale sales for that year amounted to $70,322.17. These total gross profits are 9.97 per cent of the total sales.

The petitioner's total gross retail sales for the year 1925 amounted to $1,648,112.26. The total gross profits upon those retail sales were $251,952.70. These total gross profits are 15.29 per cent of the total retail sales. The petitioner would have saved $167,065.92 if it had purchased the butts which it sold in 1925 at the market price instead of tanning these butts at its own tannery. That is the figure I previously described in my calculations for the year 1925. This figure of $167,065.92, as compared with the petitioner's actual profits for that year, shows a difference of $84,886.88. The petitioner's gross profits for that year of the retail business amounted to $251,952.70.

The petitioner's total merchandise or wholesale sales for the year 1924 amounted to $566,856.15. The gross profits on those merchandise or wholesale sales for that year were $98,708.12. The percentage relationship between those total wholesale sales and the gross profits thereon is 17.41 per cent.

The petitioner's total retail business for the year 1924 amounted to $1,549,188.09, and the total gross profits on those retail sales for that year were $304,578.55. This total gross profit is 19.66 per cent of the total gross sales.

The average market price per pound for butts for the year 1924 was 55.25 cents per pound. During that year, the petitioner's total sales in pounds of butts amounted to 2,888,785 pounds. If the petitioner had purchased in the market at the market price the butts it sold in 1924 rather [fol. 147] than tanning the leather at its own tannery, its gross profits would have been $252,970.90 greater. I found our actual gross profit on the retail business was $304,-

578.55. That figure, as compared with the calculated profit of $252,970.90, shows a difference of $51,607.65—the petitioenr's actual profits exceeding the calculated profit by that figure.

The petitioner's total merchandise or wholesale sales for the year 1923 amounted to $639,006.67, and the total gross profits on those sales for that year were $69,713.85. These gross profits are 10.91 per cent of the gross sales.

The petitioner's total retail sales for the year 1923 amounted to $1,901,930.41. The total gross profits made on those sales for that year were $330,699.95, or 17.39 per cent of the total gross retail sales. If the petitioner had purchased the butts which it sold in 1923 in the market at the average market price, its gross profits would have been $184,796.70 greater than they actually were. This figure of $184,796.70, as compared with the petitioner's actual gross profit on its retail business for 1923, shows a difference of $145,903.25, as the petitioner's retail gross profit for that year amounted to $330,699.95.

Our cost of tanning leather in 1926 at our tannery was 13.84 cents per pound. During that year we tanned 5,299,637 pounds of leather at our tannery. The average prices per pound charged during the year 1926 on tanning contracts were 11 to 13 cents, with an average of 12 cents per pound. It cost us 1.84 cents more per pound to tan leather at our own tannery in 1926 than it would have cost to have had it tanned at these average tanning contract prices. And it cost us $97,513.32 more to tan the 5,299,637 pounds of leather at our own tannery that year than it would have cost if we had this leather tanned by some other tanner at the average prevailing contract tanning price.

Our cost of tanning leather per pound at our tannery in 1925 was 13.67 cents. We tanned 4,796,036 pounds that year. The tanning contract prices for 1925 were the same [fol. 148] as for 1926; that is, 11 to 13 cents, with an average of 12 cents per pound. It cost us 1.67 cents more per pound to tan leather at our tannery in 1925 than it would have cost us to have had it tanned by another tanner at these prevailing contract prices. And it cost us $80,093.80 more to tan our entire output that year at our tannery than it would have cost us to have had this leather tanned by other tanners at these contract prices.

The petitioner's actual cost of tanning leather for the year 1924 was 12.97 cents per pound. During that year, we tanned 4,835,888 pounds at our tannery. There were few tanning contracts that year; I understand there were no prices available. Our actual cost of tanning our entire output for the year 1924 was $627,214.67. To arrive at that figure, I multiplied the cost of tanning of 12.97 cents by the number of pounds of leather tanned for that year of 4,835,888 pounds.

Our actual cost of tanning during the year 1923 was 13.95 cents. The prevailing prices on tanning contracts for that year were 14 to 15 cents, with an average of 14½ cents per pound. It cost us .55 cents less to tan leather at our tannery during 1923 than it would have cost us to have had our leather tanned by other tanners at these prevailing contract prices. And, on our entire output, it cost us $28,002.21 less to tan at our tannery that year than if we had had this leather tanned by tanners at these contract prices.

We have two publications, the Pratt Brothers Company, who give us a daily report of the hide market; and the Shoe and Leather Reporter, which publishes a magazine weekly. We are a subscriber to the Pratt Brothers publication and subscribed for it during the years 1923, 1924, 1925 and 1926. Their publication shows the market prices for green packers steer hides for the year 1926. The prices range between 11½ and 16 cents. I have calculated the average market price for green packers steer hides for the year 1926. It was 14 cents. To arrive at the figure, I took the average figures for each month furnished by Pratt Brothers and added the prices for each month and divided by 12, which gave me 14 cents.

[fol. 149] The Shoe and Leather Reporter of October 13, 1927, gave a chart from 1912 to 1926, and they show an average market price for steer hides of 14.08 cents.

We purchased 4,491,759 pounds of green packer steer hides in 1926, and we paid $602,805.91 for them. The average price per pound of these hides is 13.42 cents. To arrive at this figure, I divided the total weight of steer hides purchased into the amount paid for them. We paid .58 cents per pound less for these hides, which we purchased during 1926, than the average market price. We paid $26,052.20 less for our entire purchase of green steer hides for the year 1926 than we would have paid had we paid the market price for those hides.

Pratt Brothers' Bulletin shows the prices for green packers' cow hides for the year 1926 to be between 11 and 14½ cents. I have calculated the average market price for green packers' cow hides for 1926 and found it to be an average of 13 cents per pound. I arrived at that average price by the same method of calculation I have described with regard to the green packers' steer hides. During 1926, we purchased a total of 1,302,099 pounds of green packers' cow hides, and we paid a total of $163,863.54 for these hides. We paid an average price of 12.58 cents per pound for these cow hides. I arrived at this average by the same method of calculation I did with regard to the average price paid by us for green steer hides. We paid .42 cents less per pound for green packers' cow hides than we would have paid had we purchased these cow hides at the market price. And we paid $5,468.81 less for our entire purchases of green packers' cow hides for the year 1926 than we would have paid had we purchased these at the average market price. To arrive at that figure, I multiplied the .42 cents per pound by the number of pounds of cow hides purchased. As a result of these hide purchasing operations, our gross profits for the year 1926 were $31,521.01 greater than our profits would have been had we purchased all these hides in the market at the prevailing market prices. To arrive at that figure, I added the esti-
[fol. 150] mated profit on the steer hides of $26,052.20 to the estimated profit on the purchase of cow hides of $5,468.81 and have a total estimated profit of $31,521.01.

Pratt Brothers' Bulletin shows the market price for green packers' steer hides for the year 1925. Those monthly prices range between 14 and 17½ cents. I have calculated the average monthly price and find it to be 16 cents. I arrived at that figure by the same method I described wth regard to 1926, by adding the monthly average prices and dividing by 12.

The Shoe and Leather Reporter, for the date mentioned, October 13, 1927, shows the average price of green packers' steer hides for that year to be 15.96 cents. During the year 1925, we purchased 5,052,552 pounds of steer hides at a value of $780,051.46. I have calculated the average price per pound paid by us for these steer hides and find it to be 15.44 cents per pound. We paid .56 cents less per pound for these hides for the year 1925 than we would

have paid had we purchased them at the market prices. On our entire purchases of green packers' steer hides for 1925, we paid $28,294.29 less than we would have paid had we purchased them at the market prices. I arrived at that figure by the same method of calculation I described with regard to 1926.

Pratt Brothers' Bulletin shows the average prices for green packers' cow hides for the year 1925 to be between 13¼ to 16 cents. The average price is 14.75 cents. I arrived at that figure by the same method of calculation I described for 1926. During the year 1925, the petitioner purchased 708,551 pounds of green packers' cow hides and they cost us $101,670.63, or an average of 14.35 cents per pound. I arrived at this figure by the same method of calculation I have previously described. We paid .4 cents less per pound for these hides which we purchased during 1925 than the average prevailing market price. We paid $2,834.20 less for our entire purchase of green packers' cow hides for the year 1925 than we would have paid had we purchased these hides at the average market price. Due to our hide purchasing operations for the year 1925, [fol. 151] our gross profits were $31,128.49 greater than our profits would have been had we purchased these hides at the prevailing market prices. I arrived at that figure by adding the estimated profit on the steer hides of $28,294.29 to the estimated profit on the cow hides of $2,834.20, a total of $33,128.49.

The Pratt Brothers' Bulletin, for the year 1924, published the average market price for green packers' steer hides. They showed a range of 10¾ to 18 cents. From these prices, I have calculated the average market price per pound for that year. It is 14½ cents. I arrived at that figure by the same method I have previously described.

The chart of the Shoe and Leather Reporter for October 13, 1927, shows the average market price for green packers' steer hides for the year 1924; it shows 14.67 cents. During the year 1924 we bought 5,782,409 pounds of steer hides and paid a total amount of $759,816.45 for these hides, or an average of 13.14 cents per pound. I arrived at that figure by dividing the weight into the value. We paid 1.36 cents less per pound for green packers' steer hides which we purchased in 1924 than we would have paid

had we purchased these at the average market price, or a total of $78,640.76 on our entire purchases of green steer hides for 1924.

Pratt Brothers' Bulletin shows the average monthly market prices for green packers' cow hides for the year 1924. It shows a range of 9 to 15½ cents. I have calculated the average market price per pound for those hides and find it to be 12 cents. I arrived at that figure by the same method of calculation I have previously described. During 1924, we purchased a total of 675,283 pounds of cow hides, and we paid $66,669.81 for these hides or an average of 9.87 cents per pound. I arrived at that figure by dividing the weight into the value. We paid 2.13 cents less per pound for these hides than if we had purchased them at the market price. We paid $14,386.66 less for our entire purchases of green packers' cow hides for that year than we would have paid had we purchased them at [fol. 152] the average market price. I arrived at that figure by multiplying the 2.13 cents by the number of pounds of cow hides purchased. Due to these purchasing operations of our hides, our total gross profits for the year 1924 were $93,026.42 greater than the gross profits would have been had we paid for these hides the prevailing market prices.

Pratt Brothers' Bulletin for the year 1923 showed a range of 13½ to 20½ cents in the prices of green packers' steer hides. I have calculated the average price per pound and find it to be 16¾ cents per pound. I arrived at that figure by adding the 12 monthly figures and dividing by 12.

The Shoe and Leather Reporter for October 13th, 1927, shows the average market price for green packers' steer hides for 1923 to be 16.46 cents per pound. We purchased 4,834,375 pounds of green packers' steer hides in the year 1923 at a total cost of $715,397.75, or an average price per pound of 14.80 cents. We paid 1.95 cents per pound less, on the average, for green packers' steer hides during the year 1923 than the average market price. On our entire purchases of green steer hides for the year 1923, we paid $94,270.31 less than we would have paid had we purchased them at the prevailing market prices. I arrived at that figure by multiplying the 1.95 cents by the number of pounds of steer hides purchased, or 4,834,375 pounds, and I have a total result of $94,270.31.

Pratt Brothers' Bulletin, for the year 1923, shows the prevailing market prices for green packers' cow hides to be a range of from between 10 to 16 cents, with an average price of 13 cents. I arrived at that average price by the same method of calculation I have described.

The Shoe and Leather Reporter, for the year 1923, shows the average market prices for green packers' cow hides to be 14.21 cents per pound.

The petitioner's total purchases of green packers' cow hides for the year 1923 was 1,401,746 pounds, and the total amount paid for those hides was $219,293.27, or an average of 15.64 cents per pound. We paid 2.64 cents more per [fol. 153] pound than the prevailing market prices, or a total of $37,006.09 more for our entire purchases of green packers' cow hides during the year 1923 than if we had paid the market price for them. As a result of our hide purchasing operations for the year 1923, our gross profits were $57,264.22 more than our profits would have been had we purchased these hides at the prevailing market prices. To arrive at that figure, I deducted the amount we paid of $37,006.09 more than the market price from the $94,270.31, the estimated profit on steer hides, and had a total of $57,264.22.

The petitioner's total gross sales for the year 1926 were $2,451,738.44. Our total sales for 1926 to customers within the State of North Carolina were $6,376.01.

The petitioner's gross sales for the year 1925 were $2,413,581.71. To customers within the State of North Carolina for 1925, our total sales were $7,993.76.

The petitioner's gross sales for the year 1924 were $2,167,000.51. To customers within the State of North Carolina for 1924, our total sales were $4,817.73.

The petitioner's total gross sales for the year 1923 were $2,508,332.56. To customers within the State of North Carolina for 1923, our total gross sales were $6,727.14.

The petitioner's total assets for the year 1926 were $2,448,041.64. Our total net profit was $106,727.55. This net profit is 4.37 per cent. of the total assets.

Our gross sales for the year 1926, less returns and allowances, amounted to $2,309,070.15. The profit of $106,727.55 is 4.6 per cent of those total sales. To arrive at those percentage figures, I divided the total gross sales,

less discounts and allowances, into the net profit of $106,727.35.

The petitioner's total assets for the year 1925 were $2,409,377.06. The total gross sales, less discounts and allowances, for the year 1925, were $2,286,731.86. Our net profit for that year was $139,043.43. This net profit is 5.75 per cent. of the total assets, and 6 per cent. of the total net sales.

[fol. 154] The petitioner's total assets for the year 1924 were $2,357,029.33. The total sales, less discounts and allowances, were $2,109,021.39. Our net profits on these sales were $253,921.82, or 10.8 per cent. of the total assets, and 12 per cent. of the total net sales.

The petitioner's total assets for the year 1923 were $1,693,385.10. Our total sales, less discounts and allowances for the year 1923, were $2,485,867.55. Our net profits for that year were $230,279.40, or 14.2 per cent. of the company's total assets for that year, and 9.2 per cent. of the total sales less discounts and allowances.

The calculated buying profit of the petitioner made upon its purchases of green hides during the year 1926 was $31,321.01. That is the figure I have previously described the calculation of in detail. I calculated the petitioner's selling profit for the year 1926 to be $195,304.22. I have previously described the calculation of that figure in detail. The petitioner showed a loss of $61,735.62 during the year 1926 from the manufacturing end of its business. I have previously described the calculation of that figure in detail. From these figures just given, the calculated gross profit of the petitioner is $164,989.61. Our actual gross profit, resulting from the different operations for the year 1926, was $169,250.90. That figure of $169,250.90 does not appear on the books of the company, but it can be calculated from the records for the two six months' periods. The calculation is arrived at by adding the wholesale and retail business profits for each six months period. In other words, the gross profit from the wholesale and retail business for the first six months period of the year added to the same figures for the second six months period of the year, totaled up for 1926, will give you $169,250.90. This actual profit of the petitioner, as compared with the calculated profit from these operations I have just described, shows a difference of $4,261.29.

None of the items of profit from these different operations of the petitioner have their sources within the State of North Carolina, because the purchase of hides and the [fol. 155] selling of the leather is done in New York. From my calculations, the manufacturing operated at a loss of $61,735.62 for that year, the year 1926.

The petitioner's profit, from its buying operations for the year 1925, was $31,128.49, and its profit from tanning operations for that year was $84,866.88. Our calculated profits, from our selling operations for that year were $167,065.92. I have previously described the calculation of these figures—$31,128.49, $84,886.88 and $167,065.92—in detail. From these figures, the total calculated gross profit of the petitioner for the year 1925 was $283,081.29. I arrived at that figure by adding the three estimated profits on buying, tanning and selling. Our actual gross profit, as the result of our operations for the year 1925, was $322,274.87. That figure does not appear on the books of the company, but it can be calculated from the two six months profit and loss statements, by adding the profits for each of the six months periods I have previously described. There is a difference of $39,193.58 between this actual profit and the calculated profit. I cannot account for this difference, but we must have made a profit from good merchandising and purchasing of hides. This difference of $39,193.58 is about 14 per cent of the actual gross profits of the petitioner for the year 1925. During that year, 26 per cent of the petitioner's income had its source from its manufacturing operations in the State of North Carolina. To arrive at that figure of 26 per cent, I divided the total profit of $322,274.87 into the estimated profit of tanning of $84,886.88.

The petitioner's buying profit for the year 1924 was $93,026.42. Our profit, as the result of our tanning and manufacturing operations for that year, was $51,607.65. Our calculated selling profit for the year 1924 was $252,970.90. I have previously described in detail the calculation of each of those figures—$93,026.42, $51,607.65 and $252,970.90. The total calculated gross profit of the petitioner from its operations for the year 1924 was $397,[fol. 156] 604,97. The petitioner's actual gross profit, as the result of its buying, manufacturing and selling opera-

tions for the year 1924, was $403,286.67. This figure does not appear on the books of the Company, but it can be calculated from the two six months profit and loss figures. The petitioner's actual gross profits for the year 1924, from these operations, were $5,681.70 greater than the calculated profits. This difference is about one per cent of the actual gross profit. Thirteen per cent. of the petitioner's gross profits from these operations had their source from operations within the State of North Carolina. To arrive at that figure, I divided the total gross profit of $406,286.67 into the estimated manufacturing or tanning profit of $51,607.65 and had a 13 per cent. average.

The petitioner's calculated buying profit for the year 1923 was $57,244.22. The calculated profit derived from its tanning and manufacturing operations for that year was $145,903.25. The calculated profits from its selling operations for that year were $184,796.70. I have previously described in detail the calculation by which I arrived at these figures just mentioned. From these figures the total calculated gross profit of the petitioner from these operations was $387,944.17. The petitioner's actual gross profit for that year was $400,413.80. This figure does not show on the books of the Company, but it can be calculated from the two six months profit and loss statements. There is a difference between this calculated gross profit and the actual gross profit of the Company of $12,469.63. Thirty-seven per cent of these actual gross profits for 1923 had their source from the manufacturing and tanning operations of the petitioner within the State of North Carolina. I arrived at that figure, by dividing the total actual profit of $400,413.80 into the estimated manufacturing or tanning profit of $145,903.25 and had a percentage of 37 per cent.

For the four years—1923, 1924, 1925 and 1926—on the average, 17 per cent of the petitioner's income had its source from the manufacturing and tanning operations within the State of North Carolina. During those years, [fol. 157] the petitioner paid all taxes assessed against it by the State of North Carolina and its subsidiaries. They included city tax, city franchise, county tax, State tax, State franchise tax and land tax and the present income tax. These taxes were paid for each year.

For the year 1923, the petitioner paid $9,434.46 on its Asheville city taxes. It paid $150 on its Asheville city franchise tax; the city franchise tax is the same for every year—$150. In 1923, the petitioner paid $7,624.58 as county tax, and $622.70 as a State franchise tax. It paid $1,217.48 on its timber land for that year.

Outside of the franchise tax, the petitioner paid taxes to the City of Asheville for the year 1924 the sum of $9,014.08. It paid $5,874.86 in county taxes, and it paid the State $573.20 as a franchise tax. It paid $1,264.03 on its timber land for that year.

For 1925, the petitioner paid the City of Asheville $10,969.47 for taxes, outside of the franchise tax. It paid $7,149.30 in county taxes, and $902.69 as a State franchise tax. It also paid $1,534.07 tax on its timber land for that year.

For 1926, the petitioner paid the City of Asheville $11,107.56, exclusive of franchise tax. It paid $9,501.56 in county taxes, and $902.69 as a State franchise tax. It also paid $1,560.88 tax on its timber land for that year.

In addition to these taxes just mentioned, the petitioner paid income tax for each of the years in question.

This is a true, accurate and complete copy of the asset side of the balance sheet of the petitioner for the year 1926. (Producing paper.)

The asset side of the balance sheets of the petitioner for the years 1926, 1925, 1924 and 1923 were introduced in evidence but are not set out as exhibits for the reason that the information therein contained is included in Exhibits 5, 6, 7, 8 and 9 introduced later and attached to the deposition.

In preparing the corporation income tax return of the petitioner for the years 1923, 1924, 1925 and 1926, the [fol. 158] method of proportioning the part of the income that was taxable within the State of North Carolina was as assets in the State of North Carolina to the total assets.

In making those proportions, the intangible assets of the Company, such as accounts receivable, cash in hand, cash in bank, good will and our particular and peculiar method of merchandising were not taken into consideration.

The corporation income taxes, which were assessed against the petitioner for the years in question, were not proportioned in accordance with the sources of petitioner's income for those years.

In arriving at these taxes, the profits that the petitioner made by its peculiar and special method of merchandising, were not considered in proportioning the income which was earned in North Carolina.

Cross-examination.

By Mr. Siler:

The total outstanding capital stock of the petitioner, at the end of the fiscal year 1923, amounted to $1,000,000. There was some stock sold in 1923. (Referring to books.) It was sold at $60 a share. The par value is $100 per share. There were twenty stockholders of record at the end of the year of 1923. (Examining book.) A 6 per cent dividend was declared for the year 1923. The aggregate sum of $60,000 was paid to stockholders as dividends in the year 1923.

The total outstanding capital stock of the petitioner was the same for the year 1924. We did not sell any stock that year. The stockholders of record were practically the same in 1924 as in 1923. A 6 per cent dividend was declared and paid for the year 1924. The aggregate amount paid to the stockholders for 1924 was $60,000.

The same capital stock, in the same amount, was outstanding for the year 1925. A 7 per cent dividend was declared and paid that year, so that the aggregate amount paid in dividends to stockholders that year was $70,000. [fol. 159] The same capital stock was outstanding for the year 1926. A 4 per cent dividend was paid that year. The aggregate amount of $40,000 was paid to the stockholders as dividends for that year. During all these years, the number of stockholders had been practically the same. It is what is known as a close corporation; the stockholders are practically all of the same family.

I know what books of account are kept at the Asheville office. We have a cash journal, a journal; we have what we call manufacturing cost sheets, payroll books, inventories, and so on. In compiling the data for this investigation, I used such figures as the total of pounds of leather produced and finished from those records. I have been in Asheville and examined some of the books. I did not make that examination with a view to preparing the statements

that I have given in this hearing. It was done before this was anticipated.

The petitioner has, at all times, kept its tanning operations and its selling operations so segregated as to ascertain what department shows a profit and what shows a loss. That system has been in operation all these years.

In order to assemble these tables which have been prepared and placed in evidence, I have called to my aid stock quotations obtained from newspaper market reports and from trade journals and such like publications, as to estimates.

On the stock market, it is the uncertainty of what the market may be that makes dealing on the market rather hazardous. It is very easy to take a given period past and figure how, if you had sold or bought on the fortunate side of the market each time, you could have always won. But our quotations in the leather trade give prices of actual sales and all the leather markets guide their future prices by the quotations given by the various concerns. I don't know whether cotton dealers do likewise.

During these years that are under investigation, it is my theory that the tannery process has not been profitable but that the profit that has accrued to the operation of the busi- [fol. 160] ness of the petitioner has come from the selling of leather and the buying of hides. Those two branches have been profitable.

According to our calculations for 1925, 1924, 1923, we did make a certain percentage of profit from our tanning and manufacturing operations.

I have not figured which branch of the business was unprofitable—the tanning or the buying and selling—for the year 1920. And I did not figure as to those matters for the year 1921. I have only the figures for 1923, 1924 and 1925, and also for the year 1919. We determined upon the year 1919 as the basis of our calculations, because 1919 was the year we bought such a large quantity of rough butts. That was the year that we bought a larger quantity than usual of leather that was already tanned. Despite the fact that it turned out profitably, we did not buy so large a per cent of tanned leather in 1920, but we did buy some. Nor did we buy so large a per cent in 1921, nor in 1922; I did not know the per cent we bought already tanned in 1923; I

would have to figure that out. Since 1919, we have not bought very much leather already tanned. Since then, the tanned leather we bought has been a very small percentage in comparison with the volume of business we did.

I have no figures assembled that would indicate exactly what per cent was bought already tanned for the years 1923, 1924, 1925 and 1926. The leather that we bought already tanned, it was necessary afterwards to curry or finish it. That was done at Asheville. That process cost about 7 cents per pound for 1919. We have the cost of currying for each year. It cost us about 7 cents in 1923 to curry our leather. I arrived at that cost by dividing the total pounds of leather finished or curried into the total expense for currying. The cost for currying in 1924 was 7.43 cents; in 1925 it was 8.24 cents; in 1926 it was 8.86 cents.

During the years 1923, 1924, 1925 and 1926, based on our experience in the year 1919, I estimated that the Company would have made more, or declared a larger profit, by buying the tanned leather than it would have by tanning [fol. 161] itself. But practically all these years, we have gradually bought less and less tanned leather. I could not say that we have tanned more and more each year. We tanned about an equal quantity each year. A large quantity of our total output for each of these years has been leather that the Company has tanned itself. It is a fact that the good reputation of the company is built upon its ability to properly tan leather for the various uses of the trade. As stated, we have not bought any appreciable amount of tanned leather since 1919. We feel that the leather we tan ourselves is better than we could buy in the open market, and get a better price for it.

In my calculations for 1919, I show the petitioner's profit was considerably more per pound for that year than any year subsequent thereto; it would indicate that we had made more by buying the rough butts. I am not sure why we stopped buying tanned leather altogether. Perhaps the general manager of our tannery could tell you better; but my impression is we felt that we could tan the leather better by tanning it ourselves than buying the butts and finishing them. By tanning a more salable product than you can buy in the open market, part of the profit on that sale is

due, to a certain extent, to the particular manner in which the goods are prepared.

In arriving at the cost of the leather sold each year, I used only the amount of leather actually bought within that fiscal year and the amount actually sold within that fiscal year. I did not take into consideration any inventory that might have been on hand at the close of the previous year, or the price paid for such leather. If we had bought in the fall of 1922 and had on hand at December 31, 1922, a quantity of leather costing less than the leather did in 1922, it would affect the calculations, but in figuring for the four years, the one carried over for the next year, I should think, would balance. I do not think it would cause a great fluctuation, because I do not think the prices changed a great deal. [fol. 162] For the year 1923, our actual profits were more than the calculated profits; just for that year. Our calculated profits were calculated on the purchases and sales of hides, plus the tanning costs. This difference could have been the profit of the tannery, as well as for the purchases and sales. My calculations are calculations of profit from the purchase of hides and the profit from the sale of tanned goods. If our actual profits were in excess of that, such excess must necessarily be profits of the tannery.

The information in regard to the prices charged in tanning contracts during the different years, and what the different tanneries over the country charged for tanning, is just general knowledge in the trade; that those were the prevailing prices. They vary very little.

In arriving at my calculations as to market price, I got the figures from two different journals. Their quotations are based on what have actually been sold; they are based on actual sales previous to the issuance of the report. I stated yesterday that the average market selling price for 1924 was 55.25 cents per pound. I also stated that the petitioner received an average of 68.96 per pound. The journals referred to had included the sales made by the petitioner in arriving at their average of 55.25; we give our quotations in to them.

The prices we receive for leather do not depend upon the season, but the prices do vary according to demand. The prices jump only according to what it would cost us to buy the hides. Our sales prices are more or less based on what it costs us for hides. The average market selling price for the year 1924 was 55.25. At some period during the year,

it must have been a good deal less than that, but only on the No. 3 grade. In the computation I gave you the average price of the No. 1 and No. 2 and No. 3 grades of leather.

In this testimony, I was talking about the average sale price for leather as a whole, the market price; and the average price which we received, a great deal greater than that. [fol. 163] It is true that we always do get more than the market, because of what we consider the superiority of our product, and also because we cut up our leather according to what our customers need. It is done at Asheville, and some in New York.

In making these calculations that I have made, arriving at the difference between the sale of our product and the market prices, I have not secured from any manufacturer any sale price of theirs. I have only taken the figures from the trade journals. They treat of all grades and all classes of leather; the good and the bad alike; all together; it is the general trade. I could not tell you whether the Hans Rees' Sons, Inc. enjoy the reputation of being the best tanners in the United States.

We have used actual figures from the books in making these calculations. As far as the trade reports go, of course they are estimated. The calculated profits, as shown in my testimony yesterday, are based on estimates, and the actual profits on figures from the books.

During the year 1924, the average price shown by the trade journals for the steer hides was 14.67 cents, and the average price per pound for steer hides paid by the petitioner was 13.14 cents, which is 1.36 cents per pound less than the market price. In arriving at the price of 14.67 cents, I had to take a low figure and a high figure to arrive at the average. We paid less than the market very often; sometimes more, but very seldom. I would not say that we could get one cent difference, but we might get a quarter of a cent, or half a cent a pound. It would be due to the month's take-off of the hides and packers' hides and the packers' inclination to sell. It could not be due to volume, in our case, I think, because we do not buy them in great volumes at one time. A packer might be inclined to sell to us for half a cent less because of our credit standing. There are other reputable tanneries that have a good credit standing.

In arriving at the cost of currying and tanning, labor and materials are included in that cost, and some overhead. I

[fol. 164] could not tell what percentage of the corporation's overhead is charged to the tannery, but the actual labor, the officers at the tannery, the insurance on the tannery, the taxes and insurance; half of the president's salary. The other officers' salaries are charged to New York expenses. The salesmen's salaries are charged to New York. As to the buying expense, only what we actually pay for is charged to the tannery. I have books here showing the make-up of the expense at Asheville and also at New York. The manufacturing costs, they make up themselves at Asheville. Then we add to these costs one-half of the president's salary. Mr. Rudd, our vice-president, is general manager at Asheville; his entire salary is charged to manufacturing.

Outside of the taxes the petitioner pays in North Carolina, it pays federal income tax and New York State franchise tax. The Asheville plant has to bear the biggest portion of the taxes of the corporation. The depreciation on the plant is charged in the overhead in proportion to the cost. The corporation does not own any buildings in New York, nor any land.

I could not tell you how much more the petitioner received for its product by reason of the fact that it did its own tanning. For 1925, we received about 5 cents more than the market price for butts, plus the cost of currying. We tanned 4,796,036 pounds that year, but we did not sell as much as we tanned. We sold 3,134,445 pounds of butts; but in that is not included all the odd pieces of leather we sold, such as shoulders, bellies and heads. I would not say that we had not sold all of our tanned output; I would have to look that up, but we only sold 3,134,445 pounds of butts, including the shoulders, which we based our figuring on. We received $167,065.92 more than the market price. I would say that profit was due largely to our careful cutting up of the butt and placing it where our customers required it and could sell it and make it up in belts to the best advantage.

[fol. 165] Redirect examination.

By Mr. Greenough:

In calculating the average market selling price for leather butts during the four years in question, the prices for the

entire year were consigned in arriving at the average. In calculating the average price that we received for butts during those years, our figures were the actual figures taken from our books and covered the entire year. All figures we used, with the exception of the market prices, are taken from our books. When I said our calculated figures were based on estimates, I meant the figures given in the trade reports. The other basic figures were taken from our actual records. In calculating the price the petitioner paid for green hides in any and all of the years in question, the figures were the actual figures taken for the full year. I did not take what appeared to be the lowest figure during any year and use that as a basis. I took every actual purchase that we made of that kind of hides.

It is hereby stipulated between the parties that the balance sheets attached hereto to be marked Petitioner's Exhibits 5, 6, 7, 8 and 9 for identification are copies of the balance sheets of the petitioner for the years 1922, 1923, 1924, 1925 and 1926 inclusive.

PETITIONER'S EXHIBIT 5

Hans Rees' Sons, Inc., New York

Statement of Assets and Liabilities, December 30, 1922

Assets

Cash on hand		$97,804.90
Book accounts good		292,492.51
Due from offices and employees		12,885.82
Insurance paid in advance		1,500.00
Interest paid in advance		3,928.02
Auditors on accounts		500.00
[fol. 166] Stocks and bonds		19,600.00
Merchandise stock in New York		84,523.90
Merchandise stock elsewhere		138,399.34
Hides, leather in process, bark, supplies, etc. Asheville		637,916.36
Bark lands	$40.913.13	
Real estate at Asheville	40,000.00	

Buildings and machinery at Asheville	499,284 22	
Delivery equipment at Asheville	5,845 32	
Tools, fixtures & office equipment, New York	30,327 51	
	$616,370 18	
Less reserve for depreciation	287,423 24	
		328,946 94
Good will		100,000 00
		$1,718,497 79

Liabilities

Bills payable	$272,500 00
Accounts payable	2,457 99
Acceptances on letter of credit	15,282 38
Investment loans	8,562 42
Due officers and employees	73,915 34
Rent account	791 66
Reserve for discounts	10,152 71
Reserve for employers liability	15,630 04
Reserve for insurance	2,988 80
Capital stock	1,000,000 00
Undivided profits	316,216 45
	$1,718,497 79

E. F. Gordon, Treasurer.

[fol. 167] PETITIONER'S EXHIBIT 6

Hans Rees' Sons, Inc., New York

Statement of Assets and Liabilities as of Dec. 31, 1923

Assets

Cash on hand in New York	$143,615 02
Cash on hand in Asheville	6,879 75
Book accounts—good	267,090 80
Bills receivable	0 00

Due from employees		578.29
Insurance paid in advance		1,500.00
Interest paid in advance		307.10
Accounting paid in advance		800.00
Stocks and bonds		24,500.00
Merchandise stock in New York and in transit		226,479.13
Merchandise stock in Asheville		149,279.24
Hides, leather in process, bark, supplies, etc., at tannery		481,380.65
Bark lands, North Carolina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings and machinery at Asheville	433,715.69	
Delivery equipment at Asheville	5,845.32	
Tools, furniture and office improvements, New York	28,270.83	
	$548,744.97	
Less reserve for depreciation	257,769.85	
Net book value		290,975.12
Good will		100,000.00
		$1,693,385.10

[fol. 168] Liabilities

Bills payable	$95,000.00
Accounts payable	7,678.13
Acceptances—letter of credit	0.00
Investment loans	80,938.15
Rent account	791.66
Reserve for discounts	8,480.01
Reserve for employers liability	18,587.63
Reserve for taxes	35,000.00
Reserve for insurance	3,532.00
Reserve for accounts receivable	1,000.00
Capital stock	1,000,000.00
Undivided profits	442,377.52
	$1,693,385.10

E. F. Gordon, Treasurer.

PETITIONER'S EXHIBIT 7

Hans Rees' Sons, Inc., New York

Statement of Assets and Liabilities as of December 31, 1924

Assets

Cash on hand in New York		$120,677.11
Cash on hand in Asheville		1,152.18
Book accounts—good		312,519.71
Bills receivable		1,282.70
Due from employees		300.00
Insurance paid in advance		1,500.00
Interest paid in advance		0.00
Accounting paid in advance		0.00
Stocks and bonds		24,500.00
Merchandise stock in New York and in transit		248,145.07
[fol. 169] Merchandise stock in Asheville		146,864.34
Hides, leather in process, bark, supplies, etc., tannery		554,343.43
Bark lands, North Carolina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings & machinery, Asheville	997,183.95	
Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvements, New York	25,803.88	
	$1,110,105.95	
Less reserve for depreciation	264,361.17	
Net book value		845,744.79
Good will		100,000.00
		$2,357,029.33

Liabilities

Bills payable	$0.00
Accounts payable	7,948.50
Investment loans	88,105.97
Rent account	791.66
Reserve for accounts receivable	0.00
Reserve for discounts	10,887.37

Reserve for employers' liability	20,229.09
Reserve for insurance	4,152.17
Reserve for federal taxes	30,000.00
Capital stock	1,000,000.00
Surplus	1,194,914.57
	$2,357,029.33

E. F. Gordon, Treasurer.

[fol. 170] PETITIONER'S EXHIBIT 8

Hans Rees' Sons, Inc., New York

Statement of Assets and Liabilities of December 31, 1925

Assets

Cash on hand in New York		$79,392.46
Cash on hand in Asheville		1,845.09
Book accounts—good		361,421.90
Due from employees		300.00
Insurance paid in advance		1,500.00
Stocks and bonds		24,500.00
Merchandise stock in New York and in transit		243,327.01
Merchandise stock in Asheville		161,647.48
Hides, leather in process, bark, supplies etc., at tannery		599,550.29
Bark lands, North Carolina	$40,913.13	
Real estate at Asheville	40,000.00	
Buildings & machinery at Asheville	1,031,988.91	
Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvement, New York	23,465.31	
	$1,142,572.35	
Less reserve for depreciation	306,679.52	
Net book value		$835,892.83
Good will		100,000.00
		$2,409,377.06

[fol. 171] Liabilities

Bills payable	None.
Accounts payable	$9,718.37
Investment loans	97,510.68
Rent account	791.66
Reserve for discounts	12,667.21
Reserve for employers' liability	21,893.60
Reserve for insurance	7,249.67
Reserve for federal taxes	20,000.00
Capital stock	1,000,000.00
Surplus	1,239,545.87
	$2,409,377.06

E. F. Gordon, Treasurer.

PETITIONER'S EXHIBIT 9

Hans Rees' Sons, Inc., New York

Statement of Assets and Liabilties as of Dec. 31, 1926

Assets

Cash on hand in New York	$150,705.83
Cash on hand in Asheville	11,155.48
Notes receivable ($117.37) past due	20,117.37
Customers' accounts less reserve for doubtful 1926—$10,000.00 and discounts 1926—$11,183.48; 1925—$12,667.21	237,338.32
Sundry accounts receivable and loans	4,003.80
Accrued interest on notes receivable	1,000.00
Merchandise in New York and in transit	246,185.89
Merchandise in Asheville	233,194.76
[fol. 172] Hides, leather in process, bark supplies, etc., at tannery	521,959.43
Due from Hans Rees' Sons Company	76,474.02
Tanners Products Co. stock—140 shares at cost	17,200.00
Hans Rees' Sons Co. stock—100 shares at par	10,000.00

Bark lands, North Carolina	$29,820.63	
Real estate at Asheville	40,000.00	
Buildings & machinery at Asheville	1,064,367.97	
Delivery equipment at Asheville	6,205.00	
Tools, furniture and office improvements at New York	21,431.84	
	$1,161,825.44	
Less reserve for depreciation	350,489.70	
Net book value		811,335.74
Good will		100,000.00
Insurance premium—unexpired portion		7,371.00
		$2,448,041.64

Liabilities

Trade creditors	$544.43
Officers, employees, etc., balance on deposit	97,257.23
Accrued wages and rent	6,018.55
Federal income tax, estimated	15,000.00
Reserve for employers liability	20,853.52
Capital stock	1,000,000.00
Surplus (including surplus arising from appraisal of property)	1,308,367.91
	$2,448,041.64

E. F. Gordon, Secretary.

[fol. 173] MINUTE ENTRY OF EXCEPTIONS

Petitioner then rested; whereupon the State moved to strike from the record all of the foregoing testimony of Harald B. Rees, Thomas D. McKown and Edith F. Gordon for that same was immaterial; motion granted; petitioner excepted.

Exception No. 1.

The petitioner excepted to the order of His Honor striking out all of the testimony of the witnesses, Harald B.

Rees, Thomas D. McKown and Edith F. Gordon. The petitioner then requested his Honor to make certain findings of fact and conclusions of law (Record, p. 44). His Honor declined to do so on the ground that there was no evidence in the record to sustain such findings, and the petitioner excepted.

Exception No. 2.

To the refusal of His Honor to make the findings of fact and conclusions of law requested by the petitioner, the petitioner excepted. His Honor then entered the judgment in this cause which appears in the record, p. 106.

To the foregoing judgment the petitioner excepted and gave notice in open court of appeal to the Supreme Court. All further notice waived. Appeal bond in the sum of $50 adjudged sufficient, and petitioner allowed sixty days in which to serve case on appeal, and State allowed thirty days thereafter to serve countercase or exceptions.

IN SUPERIOR COURT OF BUNCOMBE COUNTY

APPELLANT'S EXCEPTIONS AND ASSIGNMENTS OF ERROR

The appellant assigns the following errors and relies upon the following exceptions:

1. For that the Court erred in granting the respondent's motion to strike out all of appellant's evidence as immaterial at the close of the appellant's evidence, as set out in the first exception.

[fol. 174] 2. For that the Court erred in excluding as immaterial appellant's evidence proving or tending to prove that in each of the years in question it had been subjected to a tax on a much larger percentage of its income than in fact had its source in North Carolina, as set out in the first exception.

3. For that the Court erred in that it did not sustain appellant's fifty exceptions to the findings of fact of the Commissioner of Revenue, and failed to find the facts as set out in said exceptions contained in the record, as set out in the second exception.

4. For that the Court erred in that it did not sustain appellant's eight exceptions to the findings of law of the Commissioner of Revenue, and failed to find the law as set out in said exceptions contained in the record as set out in the second exception.

5. For that the Court erred in refusing to find that an income tax has been assessed against the appellant for each of the four years in question upon a much larger percentage of income than in fact had its source in business transacted or property located in the State of North Carolina.

6. For that the Court erred in refusing to find that for the year 1923 the appellant was taxed upon income allocated to North Carolina of $194,123.65, amounting to 83.7 per cent of its total net income, whereas, in truth and in fact only 37 per cent of its income for that year had its source in the operations of the appellant in the State of North Carolina.

7. For that the Court erred in refusing to find that for the year 1924 the appellant was taxed upon income allocated to North Carolina of $221,494.59, amounting to 85.89 per cent of its total net income, whereas, in truth and in fact only 13 per cent of its income for that year had its source in the operations of the appellant in the State of North Carolina.

8. For that the Court erred in refusing to find that for the year 1925 the appellant was taxed upon income allocated to North Carolina of $97,217.13, amounting to 66.32 per cent [fol. 175] of its total net income, whereas, in truth and in fact only 26 per cent of its income for that year had its source in the operations of the appellant in the State of North Carolina.

9. For that the Court erred in refusing to find that for the year 1926 the appellant was taxed upon income allocated to North Carolina of $91,286.48, amounting to 85.53 per cent of its total net income, whereas, in truth and in fact the appellant's operations in North Carolina were conducted at an actual loss and no income whatever was produced from the appellant's operations in North Carolina during that year.

10. For that the Court erred in refusing to find that for the four years in question appellant has been taxed upon

income allocated to the State of North Carolina on an average of 80 per cent of its income, while in truth and in fact only approximately 17 per cent of its income was derived from sources within the State of North Carolina.

11. For that the Court erred in refusing to find that Section 201, Chapter 4 of the Public Laws of North Carolina in 1923, as construed and applied to the appellant, was arbitrary, unreasonable and void, and repugnant to the Commerce Clause of Section 8, Article 1 of the Constitution of the United States and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

12. For that the Court erred in refusing to hold that Section 201, Chapter 101 of the Public Laws of North Carolina in 1925, as construed and applied to the appellant, was arbitrary, unreasonable and void, and repugnant to the Commerce Clause of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

13. For that the Court erred in refusing to find that the assessment of income tax against the appellant for each of the years here in question, and the collection of said taxes here complained of, is and was arbitrary, unreasonable and void, and contrary to and repugnant to the Commerce [fol. 176] Clause of Section 8, Article 1 of the Constitution of the United States, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States.

14. For that the Court erred in refusing to find that the appellant was entitled to a refund of $3,959.88, with interest from March 11, 1924, and a refund of $2,124.65 with interest from August 13, 1925, on income taxes paid for the year 1923; and to a refund of $5,221.90, with interest from March 14, 1925, and a refund of $1,536.77 with interest from August 13, 1925, on income taxes paid for the year 1924; and is entitled to a refund of $3,453.28, with interest from March 15, 1926, and to a refund of $444.11, with interest from August 13, 1926, on income taxes paid for the year 1925; and is entitled to a refund of $3,651.46, with interest from April 11, 1927, on income taxes paid for the year 1926.

15. For that the Court erred in finding no error in rulings of the Commissioner of Revenue, and in dismissing appellant's appeal.

16. For that the Court erred in rendering the judgment found in the record.

The foregoing is tendered as a correct copy of statement of case on appeal.

Harkins & Van Winkle, Attorneys for Appellant.

Service of the within case on appeal accepted, and copy received, this the 3rd day of January, 1929.

Walter D. Siler, Attorney for Respondent.

[fol. 177] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 178] IN SUPREME COURT OF NORTH CAROLINA

STATE OF NORTH CAROLINA on the Relation of R. A. DOUGHTON, Commissioner of Revenue,

vs.

HANS REES' SONS, INC.

ORDER OF SUBSTITUTION OF COMMISSIONER OF REVENUE

Upon motion, and by consent of the parties, it is ordered that Allen J. Maxwell, as Commissioner of Revenue, be made a party to this action and substituted in lieu of R. A. Doughton, former Commissioner of Revenue.

Dated April 8, 1929.

Brogden, J., for the Court.

We consent to the above Order.

Dennis G. Brummit, Attorney for State of North Carolina. Harkins & Van Winkle, Attorneys for Hans Rees' Sons, Inc.

[fol. 179] Minute entry of submission May 8, 1929, omitted in printing.

[fol. 180] IN SUPREME COURT OF NORTH CAROLINA

No. 586

STATE OF NORTH CAROLINA, on the Relation of A. J. MAXWELL, Commissioner of Revenue,

vs.

HANS REES' SONS, INC.

Civil Action

Before McElroy, J., Buncombe Superior Court

OPINION—June 16, 1930

On August 17, 1927, the defendant filed a petition with R. A. Doughton, Commissioner of Revenue, "for a rehearing and readjustment of the income tax assessed against it for the years 1923, 1924, 1925 and 1926." The defendant duly filed income tax returns for said years in accordance with the requirements of Chapter 4, section 201 of the Public Laws of 1923, and section 201 of Chapter 101 of the Public Laws of 1925. These returns are contained in the record and we deem it unnecessary to recapitulate them. On March 11, 1925, the defendant paid without protest the sum of $3,959.88, the amount of income tax as shown by its return. On March 14, 1925, the defendant paid without protest the sum of $5,221.90, the amount of tax due for the year 1924, according to its return. On March 15, 1926, the defendant paid without protest the sum of $3,453.28, same being the amount of tax due for the year 1925, according to its return. On April 11, 1927, the defendant paid under protest the sum of $3,651.46, same being the tax computed according to its return.

Thereafter the Commissioner of Revenue audited the returns filed by the defendant and assessed an additional tax. After making an examination of the returns the Commissioner of Revenue reported to the defendant as follows:

1923

[fol. 181] "Income reported to this department was $230,279.40 to which was added debts reclaimed not in-

cluded in original report of $2,552.50 and allowed dividends in the sum of $904.00, which left net income corrected to $231,927.90. You reported for the purpose of allocating income to this department total valuation of property of $1,582,297.99. He reported total value of the property allowable for allocation purposes consisting of inventories, land, buildings, machinery, equipment, furniture and fixtures of $1,148,114.14. This operated to increase your percentage from .5732 to .837. This percentage of net income of $231,927.90 equals $194,123.65 taxable at 3% and results as follows:

At 3%	$5,823.61
Previously paid	3,959.88
Balance	1,863.73
Interest	260.92
Total additional	$2,124.65

1924

For this year you reported $253,921.82 to which the deputy added income tax deducted, which is not allowable under the North Carolina law, of $3,959.88, making total net income of $257,881.70. You reported assets as a whole for allocation purposes of $2,241,654.94. He reduced this amount to $1,792,110.61. For this year he also reduced property in North Carolina from $1,536,861.36 to $1,529,323.24, allowing in both instances only inventories, land, buildings, machinery, equipment, furniture, fixtures, etc. This increased your percentage in North Carolina from .6855 to .8589. This percentage of the net income above stated makes income taxable to North Carolina $221,494.59 and results as follows:

Tax at 3%	$6,644.84
Previously paid	5,221.90
Balance	1,422.94
Interest	113.83
Total additional	$1,536.77

You reported as net income $139,043.43. The books showed income $141,339.53, plus state income tax deducted $5,221.90, making correct income $146,561.43. You reported property value as a whole for allocation purposes $2,293,-929.85. After eliminating items included which are not permitted under the law this amount was reduced to $2,147,097.12 and percentage increased from .6209 to .6632. This percentage of the total net income is $97,217.13 and results as follows:

Tax at 4%	$3,888.68
Previously paid	3,453.28
Balance	435.40
Interest	8.71
Total additional	444.11

I wish to state with reference to change in property values that under the law and decisions of this department (concurred in by the Attorney-General) that all cash, bills receivable, good will, stock in other corporations and property of like character is not allowed to be used as tangible property within the meaning of the Act for the purpose of allocating income to this State.

I sincerely trust that the above is clear and that you will favor me with your check as requested in my previous letter."

A hearing was had by the Commissioner of Revenue, and on February 22, 1928, the said Commissioner made certain findings of fact and conclusions of law which are set out in the record. These findings of fact are to the effect that the defendant in its original return had included "both tangible and intangible assets, disregarding the provision of section 311 of the Revenue Act which specifies that only real estate and tangible personal property may be used in such allocation." The same reason is given for the changes made in the returns for the years 1924, 1925, and 1926. Thereupon the Commissioner of Revenue denied the petition of defendant. Thereafter the defendant filed certain exceptions to the findings of fact and conclusions of law made by the Commissioner which were

[fol. 183] overruled by the Commissioner, and the defendant appealed to the Superior Court of Buncombe County and waived a jury trial.

The cause was heard and the following judgment entered:

"This cause coming on to be heard before His Honor, McElroy, Judge, jury trial having been waived, it being agreed that His Honor should find the facts with the same force and effect as by jury trial and render judgment thereon, it being admitted that the Commissioner of Revenue in assessing the tax complained of has followed the method set forth in Section 311 of the Revenue Act of 1927, sub-section A, and similar sections of the Act of 1923 and 1925, and that the valuation fixed for the real estate and tangible property of the complaining taxpayer, both within and without the State, is admitted to be correct, and that the total net income of the complaining taxpayer used for a basis of calculation by the Commissioner of Revenue is admitted to be correct, and that the allocation thereof for the purposes of taxation was made in accordance with the method indicated in the statute referred to, the complaining taxpayer having offered testimony as appears in the record, over the objection of the State, and upon the conclusion of the testimony the State having moved to strike out the testimony offered as immaterial, and the Court being of the opinion that such testimony is immaterial, allows the motion to strike out and holds upon the admission of the taxpayer that the statutory method has been followed and that the tax levied by the Commissioner of Revenue is a valid tax and that the section authorizing the said levy is not in violation of any constitutional rights of the taxpayer. It is therefore ordered and adjudged that the action be dismissed at the cost of the taxpayer."

From the foregoing judgment the defendant appealed.

Dennis G. Brummitt, Attorney General; Frank Nash, Assistant Attorney General; Walter D. Siler, Assistant Attorney General, for State.

Harkins & Van Winkle for defendant. Louis H. Porter, 30 Broad Street, New York City, of counsel for defendant.

[fol. 184] BROGDEN, J.:

Certain admissions were made by the defendant at the hearing in the Superior Court and set forth in the judgment. In substance these admissions were:

(a) In assessing the tax the Commissioner of Revenue followed the statutory method prescribed in Chapter 4, Section 201 of the Public Laws of 1923, Chapter 101, Section 201 of the Public Laws of 1925, and Section 311 of Chapter 80 of the Public Laws of 1927; (b) that the valuation of the real estate and tangible property of the taxpayer "both within and without the State" is correct; (c) that the total net income used as a basis for the calculation of tax is correct; (d) that the allocation of the net income for purposes of taxation was in full accord with the statute.

Therefore, the only defense left to the complaining taxpayer is the assertion that the statutes are unconstitutional. The attack upon the statutes is based upon the contention that they are so "arbitrary and unreasonable as to be repugnant to the commerce clause and the Fourteenth Amendment to the Federal Constitution."

The taxing statute is as follows: "Every corporation organized under the laws of this State shall pay annually an income tax; equivalent to four per cent of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to four per cent of a proportion of its entire income to be determined according to the following rules:

(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of encumbrances thereon.

[fol. 185] (b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

(c) The words "tangible personal property" shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money deposits in bank, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt."

An examination of the statute discloses that the "fair cash value" of the real estate and tangible personal property of the taxpayer in this State, is the numerator, and the "fair cash value" of all real estate and tangible property owned by the taxpayer is the denominator of a fraction, used by the Commissioner of Revenue in measuring and determining the amount of tax on net income due the State of North Carolina. Obviously, changes in either the numerator or denominator, the other remaining constant, would affect the value of the fraction and consequently the amount of collectible revenue. Moreover, by express provision "tangible personal property" is so defined as to exclude bank deposits, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt.

This method of measuring the tax on net income has been approved by the Supreme Court of the United States in the case of Underwood Typewriter Co. v. Chamberlain, 254 U. S., 113. The principles of law announced therein have been approved in subsequent decisions of that court, notably: Bass, Ratcliff & Gretton v. State Tax Commission, 266 U. S., 271; National Leather Co. v. Mass., 279 U. S., 413; International Shoe Co. v. Shartel, 279 U. S., 429. Furthermore, the pertinent portion of Section 22 of the Connecticut statute, construed in the Underwood case, supra, is substantially identical with ours.

[fol. 186] Manifestly, the North Carolina statute is not unconstitutional upon its face. It applies equally to both domestic and foreign corporations. It taxes net income only.

It does not undertake either in express terms or by implication to impose a burden upon property not subject to the jurisdiction of this State. It is an accepted principle of the law of taxation that "property in a state belonging to a corporation, whether foreign or domestic, engaged in foreign or interstate commerce, may be taxed, or a tax may be imposed upon the corporation on account of its property within a state, and may take the form of a tax for the privilege of exercising its franchise within the State, if the ascertainment of the amount is made dependent in fact on the value of its property situated within the State, (the exaction, therefore, not being susceptible of exceeding the sum which might be leviable directly therein,) and if payment be not made a condition precedent to the right to carry on the business, but its enforcement left to the ordinary means devised for the collection of taxes." U. S. Glue Co. v. Oak Creek, 247 U. S., 321. In the same case the Supreme Court of the United States, discussing an income tax, said:

"Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the States are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States." The same principle was stated in Atlantic Coast Line v. Daughton, 262 U. S., 413, in these words: "That a State may, consistently with the Federal Constitution, impose a tax upon the net income of property, as distinguished from the net income of him who owns or operates it, although the property is used in interstate commerce, was settled in Shaffer v. Carter, 252 U. S., 37."

[fol. 187] The petitioning taxpayer apparently conceding in its brief that the statute is constitutional upon its face, contends that the execution thereof and the application thereof to its business works out an unreasonable and highly arbitrary result and thus effects a denial of its constitutional rights. In order to establish this proposition

certain evidence was introduced in the trial court. This evidence tended to show that the petitioner was incorporated in the State of New York in 1901 and is engaged in the business of tanning, manufacturing and selling belting and other heavy leathers. Many years prior to 1923 it located a manufacturing plant at Asheville, North Carolina, and after this plant was in full operation dismantled and abandoned all plants which it had heretofore operated in different states of the union. The business is conducted upon both wholesale and retail plans. The wholesale part of the business consists in selling certain portions of the hide to shoes manufacturers and others in carload lots. The retail part of the business consists in cutting the hide into innumerable pieces, finishing it in various ways and manners and selling it in less than carload lots. In order to facilitate sales a warehouse is maintained in New York from which shipments are made of stock on hand to various customers. The tannery at Asheville is used as a manufacturing plant and a supply house, and when the quantity or quality of merchandise required by a customer is not on hand in the New York warehouse a requisition is sent to the plant at Asheville to ship to the New York warehouse or direct to the customer. The sales office is located in New York and the salesmen report to that office. Sales are made throughout this country and in Canada and Continental Europe. Some sales are also made in North Carolina. Certain finishing work is done in New York. The evidence further tended to show that "between forty and fifty per cent of the output of the plant in Asheville is shipped from the Asheville tannery to New York. The other sixty per cent is shipped direct on orders from New York. * * * Shipment is made direct from Asheville to the customer.

The petitioner also offered evidence to the effect that [fol. 188] the income from the business was derived from three sources, to-wit: (1) buying profit; (2) manufacturing profit; (3) selling profit. It contends that buying profit resulted from unusual skill and efficiency in taking advantage of fluctuations of the hide market; that manufacturing profit was based upon the difference between the cost of tanning done by contract and the actual cost thereof when done by the petitioner at its own plant in Asheville, and

that selling profit resulted from the method of cutting the leather into small parts so as to meet the needs of a given customer.

Without burdening this opinion with detailed compilations set out in the record, the evidence offered by the petitioner tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent.

Upon such evidence the petitioner earnestly contends that the taxing statute of North Carolina in its operation and application is unreasonable and arbitrary, and hence repugnant to the Federal Constitution.

The fallacy of this conclusion lies in the fact that the petitioner undertakes to split into independent sources, income which the record discloses was created and produced by a single business enterprise. Hides were bought for the purpose of being tanned and manufactured into leather at Asheville, North Carolina, and this product was to be shipped from the plant and sold and distributed from New York to the customer. The petitioner was not exclusively a hide dealer or a mere tanner of leather or a leather salesman. It was a manufacturer and seller of leather goods, involving the purchase of raw material and the working up of that raw material into acceptable commercial forms, for the ultimate purpose of selling the finished product for a profit. Therefore, the buying, manufacturing and selling were component parts of a single unit. The property in North Carolina is the hub from which the spokes of the entire wheel radiate to the outer rim.

[fol. 189] Manifestly, by virtue of the intimate and inseparable relation between the various departments of the business it would be impossible for the Legislature to allocate with mathematical accuracy or precision the profits earned within this State. This idea was expressed in the Underwood case, supra, as follows: "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the

impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State." It is true that, in the Underwood case the Supreme Court of the United States, quoting from the Connecticut court, asserted that the burden was upon the taxpayer to show that the amount of tax assessed by the State of Connecticut was not reasonably attributable to the manufacturing operations within the State. Certainly, this could not be shown, as the petitioner has sought to do in this case, by splitting up a single business into component parts and dividing the indivisible in order to reduce the tax. Indeed, in the Underwood case the taxpayer attempted to show that more than a million and a quarter of its net profits was received in other states and only a negigible part in Connecticut, and from such fact reasoned that a tax assessment of forty-seven per cent was unreasonable and arbitrary. The court, however, remarked: "But this showing wholly fails to sustain the objection."

Again in Bass, Ratcliff & Gretton v. State Tax Commission, 266 U. S., 271, the court said: "So in the present case we are of opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions, beginning with the manufacture in England and ending in sales in New York and other places,—the process of manufacturing resulting in no profits until it ends in sales,—the [fol. 190] state was justified in attributing to New York a just proportion of the profits earned by the company from such unitary business." Adams Exp. Co. v. Ohio, 165 U. S., 194.

The trial judge struck out all the evidence offered by the petitioner upon the ground that it was immaterial. This ruling, as we interpret the law, is correct for the reason that the tax was computed in accordance with a statutory method which has been approved by the court of supreme authority. Furthermore, it is admitted in the record that the method was properly applied to the net income of the petitioner. Hence, if a proper statutory method for measuring a tax has been properly applied, that ought to end the case. But conceding that the evidence was competent,

it shows beyond doubt that the petitioner was conducting a unitary business as contemplated and defined by the courts of final jurisdiction, and, if so, it is not permissible to lop off certain elements of the business constituting a single unit, in order to place the income beyond the taxing jurisdiction of this state.

The Commissioner of Revenue contends that at all events the portions of tax paid by the petitioner voluntarily and without objection or compulsion cannot be recovered even though the tax be levied unlawfully. This contention is sound and is supported by Authority. Blackwell v. Gastonia, 181 N. C., 378, 107 S. E., 218; Mfg. Co. v. Commissioners, 196 N. C., 744, 147 S. E., 284; Henrietta Mills v. Rutherford, 50 Supreme Court Reporter, 270.

We are of the opinion and so hold that the taxing statutes are constitutional and therefore do not invade the domain of the commerce clause of the Fourteenth Amendment of the Federal Constitution. Neither is the execution or practical operation of the statutes unreasonable or arbitrary, and the judgment of the Superior Court of Buncombe County is affirmed.

Affirmed.

[fol. 191] IN SUPREME COURT OF NORTH CAROLINA

No. 586

STATE OF NORTH CAROLINA ON RELATION OF ALLEN J. MAXWELL, Commr. of Revenue

vs.

HANS REES SONS

JUDGMENT—June 16, 1930

This cause came on to be argued upon the transcript of the record from the Superior Court of Buncombe County:—upon consideration whereof, this Court is of opinion that there is no error in the record and proceedings of said Superior Court.

It is, therefore, considered and adjudged by the Court here, that the opinion of the Court, as delivered by the Honorable W. J. Brogden, Justice, be certified to the said Su-

perior Court, to the intent that the judgment be and the same is hereby affirmed. And it is considered and adjudged further that the defendant and surety do pay the costs of the appeal in this Court incurred, to-wit, the sum of Thirty-five 55/100 dollars ($35.55), and execution issue therefor.

A true copy.
Dated this 16 June 1930.
Howard C. Seawell, Clerk of the Supreme Court.
Seal of the Supreme Court of the State of North Carolina.

[fols. 192 & 193] IN SUPREME COURT OF NORTH CAROLINA

[Title omitted]

PETITION OF APPEAL

Considering itself aggrieved by the final decision and judgment of the Supreme Court of the State of North Carolina in the above entitled cause, the appellant therein, Hans Rees' Sons, Inc., hereby prays that an appeal be allowed to the Supreme Court of the United States herein, and for an order fixing the amount of the bond thereon.

Dated July 1, 1930.
Kingsland Van Winkle, Louis H. Porter, Counsel for Appellant.

[fol. 194] IN SUPREME COURT OF NORTH CAROLINA

[Title omitted]

ASSIGNMENT OF ERRORS

The above named appellant, Hans Rees' Sons, Inc., believing itself aggrived by the final decision and judgment of the Supreme Court of the State of North Carolina in the above entitled cause, and having petitioned for an appeal to the Supreme Court of the United States, hereby assigns the following errors in the record and proceedings in the said case.

1. The Supreme Court of the State of North Carolina erred in refusing to find Section 201 Chapter 4 of the Public Laws of North Carolina, Session of 1923, and Section 201 Chapter 101 of the Public Laws of North Carolina, Session of 1925, unconstitutional and repugnant to Section one of the Fourteenth Amendment to the Constitution of the United States, because, as construed and applied to this appellant, they result in a taking of its property without due process of law and deprive it of the equal protection of the laws by imposing arbitrary and unreasonable taxes on it.

[fols. 195 & 196] 2. The Supreme Court of the State of North Carolina erred in refusing to find Section 201, Chapter 4 of the Public Laws of North Carolina, Session of 1923, and Section 201, Chapter 101 of the Public Laws of North Carolina, Session of 1925, unconstitutional and repugnant to the Commerce Clause of Section 8 of Article I of the Constitution of the United States, because, as construed and applied to appellant, they result in the imposition of a tax which is an invalid burden upon appellant's interstate commerce.

3. The Supreme Court of North Carolina erred in holding the taxes imposed upon appellant were constitutional and were not repugnant to the Commerce Clause of Section 8 of Article I and Section one of the Fourteenth Amendment to the Constitution of the United States.

4. The Supreme Court of the State of North Carolina erred in affirming the judgment of the Superior Court, and in refusing to reverse said judgment upon the ground that said Superior Court erred in striking out all of appellant's evidence as to the character of its business and the sources of its income as immaterial.

5. The Supreme Court of the State of North Carolina erred in holding that, although appellant had been taxed 80% of its income, evidence tending to show that only 17% of its income came from its operations in North Carolina was immaterial.

6. The Supreme Court of the State of North Carolina erred in rendering the final judgment or decree against the

appellant upon the 16th day of June, 1930, in the above entitled cause.

Dated July 1, 1930.

Kingsland Van Winkle, Louis H. Porter, Counsel for Appellant.

[fols. 197 & 198] IN SUPREME COURT OF NORTH CAROLINA

[Title omitted]

PRAYER FOR REVERSAL

Considering itself aggrieved by the final decision and judgment of the Supreme Court of the State of North Carolina in the above entitled cause, the appellant, Hans Rees' Sons, Inc., hereby files a petition for appeal to the Supreme Court of the United States and its assignment of errors, for which errors the said appellant, Hans Rees' Sons, Inc., prays that the said judgment of the Supreme Court of the State of North Carolina, dated June 16, 1930, in the above entitled cause, be reversed, and a judgment rendered in favor of the said appellant and for costs.

Dated July 1, 1930.

Kingsland Van Winkle, Louis H. Porter, Counsel for Appellant.

[fols. 199-202] Bond on appeal for $1,000.00 omitted in printing.

[fol. 203] IN SUPREME COURT OF NORTH CAROLINA

[Title omitted]

ORDER ALLOWING APPEAL—July 18, 1930

The appellant in the above entitled suit, Hans Rees' Sons, Inc., having prayed for the allowance for an appeal in this cause to the Supreme Court of the United States from a judgment made and entered in the above entitled suit by the Supreme Court of the State of North Caro-

lina on the 16th day of June 1930, and having presented and filed its petition for appeal, assignment of errors, and prayer for reversal, pursuant to the statutes and rules of the Supreme Court of the United States in such case made and provided.

And the undersigned, the Chief Justice of the Supreme Court of the State of North Carolina, being the highest court of the State in which a decision in this suit could be had, having found that the appellant in said State Court of North Carolina drew in question the validity of a statute of the State of North Carolina on the ground of its being repugnant to the Constitution of the United States, and that the decision of the said State Supreme Court of North [fols. 204 & 205] Carolina was in favor of the validity of the said statute;

It is now here ordered that an appeal be and the same is hereby allowed to the Supreme Court of the United States from the Supreme Court of the State of North Caroline in the above entitled cause, as provided by law; and it is further ordered that the Clerk of the Supreme Court of the State of North Carolina shall prepare and certify a transcript of the record, proceedings, and judgment in this cause, and transmit the same to the Supreme Court of the United States so that he shall have the same in said Court within thirty days of this date.

And it is further ordered that security for costs on appeal be fixed in the sum of One thousand dollars ($1,000.), and that the appeal bond presented by said appellant for $1,000. be and the same hereby is approved.

Dated July 18th, 1930.

W. P. Stacy, Chief Justice of the Supreme Court of the State of North Carolina.

[fol. 206] In Supreme Court of North Carolina

[Title omitted]

Præcipe for Transcript of Record—July 25, 1930

The Clerk of the Supreme Court of the State of North Carolina in preparing and transmitting the record in the above entitled cause to the Supreme Court of the United States will include in the record the following:

1. The printed record in this cause in the Supreme Court of the State of North Carolina, pages 1-177 inclusive.

2. The order of the Supreme Court of the State of North Carolina dated April 8th, 1929, substituting Allen J. Maxwell, Commissioner of Revenue, as respondent in place of R. A. Doughton, Commissioner of Revenue, resigned.

3. The opinion of the Supreme Court of the State of North Carolina rendered on the appeal in this cause.

4. The judgment of the Supreme Court of the State of North Carolina entered June 16, 1930, affirming the judgment of the Superior Court for Buncombe County in this [fols. 207 & 208] cause.

5. The appellant's petition for appeal to the Supreme Court of the United States, assignment of errors, prayer for reversal, appeal bond, and the order of the Chief Justice of the Supreme Court of the State of North Carolina allowing an appeal to the Supreme Court of the United States, dated the 18th day of July, 1930, and this præcipe.

6. The citation on appeal to the Supreme Court of the United States and the proof of service thereof on the respondent, Allen J. Maxwell, as Commissioner of Revenue, filed with you on the 25 day of July, 1930.

Dated July 25th, 1930.

Kingsland Van Winkle, Louis H. Porter, Counsel for Appellant.

Service of the foregoing præcipe acknowledged this 25 day of July, 1930.

Dennis G. Brummitt, Attorney General of the State of North Carolina.

[fols. 209-211] Citation, in usual form, showing service on Allen J. Maxwell, omitted in printing.

[fol. 212] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 213] IN SUPREME COURT OF THE UNITED STATES

STATEMENT OF POINTS RELIED UPON AND DESIGNATION TO PRINT ENTIRE RECORD—Filed Aug. 5, 1930

Statement of Points Relied Upon by Appellant

Hans Rees' Sons, Inc., appellant in the above entitled cause, in order to secure a reversal of the judgment appealed from, will rely upon the following points:

1. The Supreme Court of the State of North Carolina erred in refusing to find Section 201, Chapter 4 of the Public Laws of North Carolina, Session of 1923, and Section 201, Chapter 101 of the Public Laws of North Carolina, Session of 1925, unconstitutional and repugnant to Section one of the Fourteenth Amendment to the Constitution of the United States, because, as construed and applied to this appellant, they result in a taking of its property without due process of law and deprive it of the equal protection of the laws by imposing arbitrary and unreasonable taxes on it.

2. The Supreme Court of the State of North Carolina [fol. 214] erred in refusing to find Section 201, Chapter 4 of the Public Laws of North Carolina, Session of 1923, and Section 201, Chapter 101 of the Public Laws of North Carolina, Session of 1925, unconstitutional and repugnant to the Commerce Clause of Section 8 of Article I of the Constitution of the United States, because, as construed and applied to appellant, they result in the imposition of a tax which is an invalid burden upon appellant's interstate commerce.

3. The Supreme Court of North Carolina erred in holding the taxes imposed upon appellant were constitutional and were not repugnant to the Commerce Clause of Section 8 of Article I and Section one of the Fourteenth Amendment to the Constitution of the United States.

4. The Supreme Court of the State of North Carolina erred in affirming the judgment of the Superior Court, and in refusing to reverse said judgment upon the ground that said Superior Court erred in striking out all of appellant's evidence as to the character of its business and the sources of its income as immaterial.

5. The Supreme Court of the State of North Carolina erred in holding that, although appellant had been taxed on 80% of its income, evidence tending to show that only 17% of its income came from its operations in North Carolina was immaterial.

6. The Supreme Court of the State of North Carolina erred in rendering the final judgment or decree against the appellant upon the 16th day of June 1930 in the above [fols. 215 & 216] entitled cause.

Designation of Portions of the Record to be Printed

The Clerk of this Court will print the entire record in the above entitled cause transmitted from the Supreme Court of the State of North Carolina.

Louis H. Porter, Kingsland Van Winkle, Counsel for Appellant.

We, the undersigned attorneys for the appellee, consent to the foregoing designation of the parts of the record to be printed. This July 25, 1930.

Dennis G. Brummitt, Attorneys for Appellee, Attorney General, for Appellee.

State of North Carolina,
County of Wake, ss:

On this 25th day of July, in the year of our Lord one thousand nine hundred and thirty, personally appeared Kingsland Van Winkle before me, the subscriber, a Notary Public in for the County of Wake, State of North Carolina, and makes oath that he delivered a true copy of the within statement to Dennis G. Brummitt, Attorney General of North Carolina and Attorney for the appellee, on the 25th day of July, 1930.

Kingsland Van Winkle.

Sworn to and subscribed the 25th day of July, A. D., 1930. Mabel E. Penney, Notary Public, Wake County, North Carolina. My commission expires September 28, 1930. (Seal Mabel E. Penney, Notary Public, Wake County, N. C.)

[fol. 217] [File endorsement omitted.]

Endorsed on cover. File No. 35,256. North Carolina, Supreme Court. Term No. 334. Hans Rees' Sons, Inc., appellant, vs. State of North Carolina on the relation of Allen J. Maxwell, Commissioner of Revenue. Filed August 5, 1930. File No. 35,256.

FILE COPY

No. 334

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AUG
CHARLES ELMORE

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930.

HANS REES' SONS, INC.,

Appellant,

v.

STATE OF NORTH CAROLINA ON THE RELATION OF ALLEN J. MAXWELL, COMMISSIONER OF REVENUE,

Respondent.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA.

STATEMENT OF JURISDICTION UNDER RULE XII.

LOUIS H. PORTER,
F. CARROLL TAYLOR,
Attorneys for Appellant.

APPEAL PRINTING CO., 21 PEARL ST., NEW YORK CITY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

HANS REES' SONS, INC.,
Appellant,

v.

STATE OF NORTH CAROLINA ON THE RELATION OF ALLEN J. MAXWELL, COMMISSIONER OF REVENUE,
Respondent.

No. 334.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA.

STATEMENT OF JURISDICTION UNDER RULE XII.

Appellant submits the following statement of the basis on which it is contended this Court has jurisdiction to review, on appeal, the judgment of the Supreme Court of the State of North Carolina.

(A)

The statutory provisions believed to sustain the jurisdiction.

The jurisdiction of this Court is invoked under Section 237 (a) of the Judicial Code, as amended by Act of February 13, 1925, Chapter 229, 43 Stat. 937, U. S. Code, Ann. Title 28, Sec. 344.

The judgment of the Supreme Court of North Carolina is a final judgment in the suit under Article IV, Sections 2 and 8 of the Constitution of the State of North Carolina and Sections 615, 658, 659, 1412 and 1314 of North Carolina Code as construed in *Chavis* v. *Brown*, 174 N. C. 122.

(B)

The date of the judgment and of the application for appeal.

The decree sought to be reviewed was entered in the Supreme Court of the State of North Carolina on the 16th day of June, 1930 (R. 191).*

The petition for appeal (R. 192), assignment of errors (R. 193) and prayer for reversal (R. 195) were presented to the Chief Justice of the Supreme Court of the State of North Carolina on the 18th day of July, 1930, and the order allowing said appeal was issued (R. 199) and the appeal bond approved (R. 196) by him on the said 18th day of July, 1930. The citation on appeal (R. 203) was signed by him on the 18th day of July, 1930, and was served upon the appellee on the 25th day of July, 1930 (R. 203).

(C)

Nature of the case and rulings below.

The case was brought by appellant, a New York corporation, to recover income taxes imposed by the State of North Carolina.

(* All references to the record are to the pages of the certified unprinted record prepared by the Clerk of the Supreme Court of the State of North Carolina and on file with the Clerk of this Court. The record has not yet been printed in this Court.)

Appellant is engaged in the manufacture and sale of leather and operates two factories, one in North Carolina and one in New York.

North Carolina has collected annual taxes upon 80% of the appellant's total net income, while appellant contends that only 17% of such income was derived from its operations in that State.

The principal question litigated in the court below and involved in this appeal is the constitutional validity of the North Carolina statute, which provides an inflexible rule of apportioning corporate income subject to the income tax, and which, as applied to the appellant, has resulted in an unreasonable and arbitrary tax.

Taxes for the years 1923, 1924, 1925 and 1926 are involved. The taxes for the first two years were imposed under Section 201, Chapter 4 of the Public Laws of North Carolina of 1923, and for the latter two years under Section 201, Chapter 101 of the Public Laws of North Carolina of 1925. The Laws of 1925 amended the earlier Section in matters not relevant to any questions involved in this case. The State Court has considered the entire matter to depend upon the validity of the Act of 1925, which reads as follows:

> "CORPORATIONS. Every corporation organized under the laws of this State shall pay annually an income tax, equivalent to four per cent. of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to four per cent. of a proportion of its entire income to be determined according to the following rules:
>
> "(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership,

sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible (personal) property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of incumbrances thereon.

"(b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

"(c) The words 'tangible personal property' shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money deposits in bank, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt."

Appellant followed the statutory procedure for the review of the taxes by the Commissioner of Revenue of the State of North Carolina with an appeal from his decision to the Superior Court of Buncombe County, North Carolina, where the case was tried *de novo*, and resulted in a judgment against the taxpayer.

From this judgment an appeal was taken to the Supreme Court of North Carolina, which is the highest court in the State, and that Court entered final judgment affirming the judgment of the Superior Court, upholding the constitutional validity of the statutes involved and dismissing the case.

The appellant has throughout all these proceedings challenged the constitutionality of the statute (Petition for Review, R. 1, 9; Exceptions to Findings of Commissioner, R. 77, 101; Appeal to Superior Court, R. 104; Assignment of Errors, State Supreme Court, R. 173; Opinion of State Supreme Court, R. 184).

The statute provides an apportionment of income in accordance with the location of tangible property owned, and disregarding all other factors or considerations. The appellant introduced exhaustive evidence as to the character of its business and the sources of its income, and showed that as applied to it the statutory allocation of tangible property owned alone produced an unreasonable result (R. 109 to 165, inclusive). The effect of the evidence was to show that for the four years the average income of appellant derived from North Carolina sources amounted to approximately 17% of its total income (R. 154 to 158; Opinion, R. 188).

This evidence was received under a stipulation waiving objections to relevancy and competency, but reserving objection on the ground of materiality (R. 109). At the close of the case in the Superior Court all of appellant's evidence was stricken out as immaterial (R. 173).

The opinion of the Supreme Court considered two questions: One, whether or not the statute was unconstitutional on its face, and, second, whether or not evidence showing that the statute operated unfairly to the appellant was material to the case (R. 180 to 190).

The following quotation from the opinion of the State Supreme Court presents the constitutional question:

> "Without burdening this opinion with detailed compilations set out in the record, the evidence offered by the petitioner tends to show that for the

years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent." (R. 188).

The Court, nevertheless, held that this evidence was immaterial in face of the fact that under the statutory allocation the appellant had been taxed upon 80% of its income.

The constitutional questions that appellant contends give this Court jurisdiction of this case are, therefore, as follows:

1. Is a state income tax law constitutional which apportions income on the basis of location of tangible property owned alone and which, as construed and applied to appellant, imposes a tax upon 80% of its income, while in fact only 17% of such income is derived from business or operations in the state?

2. Can the constitutional invalidity of the statute be avoided by excluding as immaterial evidence showing the arbitrary and unreasonable application of the statute to the taxpayer?

These questions were expressly left undecided by this Court in *Underwood Typewriter Co. v. Chamberlain*, 254 U. S. 113.

The judgment appealed from is a final judgment of the Supreme Court of North Carolina which is the highest court in the State having jurisdiction of the case. (Order Allowing Appeal, R. 199; State Constitution and statutes cited above in (A).)

(D)

Cases believed to sustain jurisdiction.

The following decisions of this Court are believed to sustain jurisdiction of this appeal:

Fisk v. *Kansas*, 274 U. S. 380, 385;
Dahnke-Walker Milling Co. v. *Bondurant*, 257 U. S. 282;
Cudahy Co. v. *Parramore*, 263 U. S. 418, 422;
Kansas City So. Ry. Co. v. *Road Improvement Dist.*, 266 U. S. 379, 385;
Nashville, Chattanooga & St. Louis Ry. v. *White*, 278 U. S. 456;
Safe Deposit & Trust Co. of Baltimore v. *Virginia*, 280 U. S. 83.

We respectfully submit that this Court has jurisdiction of this appeal by virtue of Section 237 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Respectfully submitted,

LOUIS H. PORTER,
F. CARROLL TAYLOR,
Counsel for Appellant.

FILE COPY

JAN 80
CHARLES ELMORE

No. 334

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

HANS REES' SONS, INC.

Appellant

v.

STATE OF NORTH CAROLINA, on the Relation of ALLEN J. MAXWELL, Commissioner of Revenue

Respondent

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA.

BRIEF AND ARGUMENT FOR APPELLANT

LOUIS H. PORTER
F. CARROLL TAYLOR
KINGSLAND VAN WINKLE
Counsel for Appellant

APPEAL PRINTING CO., 30 VESEY ST., NEW YORK CITY

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

HANS REES' SONS, INC.,
Appellant,

v.

STATE OF NORTH CAROLINA, on the Relation of Allen J. Maxwell, Commissioner of Revenue,
Respondent.

No. 334.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA.

Reference to Report Below.

The opinion of the State Supreme Court is reported as *Maxwell, Commissioner of Revenue* v. *Hans Rees' Sons, Inc.*, 199 N. C. 42. The same case is also reported in 153 S. E. Rep., 850.

No opinion was written in the Superior Court of Buncombe County, where the case originated.

Statement of Jurisdiction.

In accordance with Rule XII, the appellant duly filed a statement showing the jurisdiction of this Court. Consideration of jurisdiction was reserved until the argument of the case on the merits. Appellant submits here a summary statement of the jurisdiction of this Court, supplementing the statement heretofore filed.

The jurisdiction of this Court is invoked under Section 237 (a) of the Judicial Code, as amended by Act of February 13, 1925, Chapter 229, 43 Stat. 937, U. S. Code, Ann. Title 28, Section 344, and under Sections 861 (a) and (b), U. S. C. A., being the Acts of January 31, 1928, Chapter 14, §1, 45 Stat. 54, and of January 31, 1928, Chapter 14, §2, 45 Stat. 54, as amended April 26, 1928, Chapter 440, 45 Stat. 466.

The judgment of the Supreme Court of North Carolina is a final judgment in a suit under Article IV, Sections 2 and 8, of the Constitution of the State of North Carolina, and Sections 615, 658, 659, 1412 and 1413 of the North Carolina Code. *Chavis* v. *Brown*, 174 N. C. 122.

The judgment sought to be reviewed was entered in the Supreme Court of the State of North Carolina on the 16th day of June, 1930 (R. 166).

The petition for appeal (R. 167), the assignment of errors (R. 167) and the prayer for reversal (R. 169) were presented to the Chief Justice of the Supreme Court of the State of North Carolina on the 18th day of July, 1930; and the order allowing said appeal (R. 169) was issued, and the appeal bond approved by him on the said 18th day of July, 1930. The citation on appeal was signed by him on the 18th day of July, 1930, and was served upon the appellee on the 25th day of July, 1930.

The case was brought by appellant, a New York corporation, to recover income taxes imposed by the State of North Carolina. Throughout the entire proceeding appellant has based its claim of right to recover in this case upon the ground that the North Carolina statute, as construed and enforced against appellant, was repugnant to the Commerce Clause and the Fourteenth Amendment of the Federal Constitution.

Taxes for the years 1923, 1924, 1925, and 1926, are involved. The statute provides an allocation of income on the basis of the location of tangible property and has been construed to allocate to North Carolina and subject to tax by that State an average of 80% of appellant's total net income. Appellant contends that only 17% of this income in fact had its source in the operations in North Carolina, and that a statute construed to impose a tax on more than four times the proportion of income of a foreign corporation actually having its source in the State is invalid.

The facts as to the source of appellant's income are set out at length (*infra*) in Point I (p. 18). The State Court struck out all of appellant's evidence as to the character of its business and the sources of its income as immaterial. The legal effect of this ruling on the constitutional questions involved is discussed (*infra*) Point II (p. 33).

The constitutionality of the statute, construed to tax 80% of income, while only 17% had its source in the State, is discussed (*infra*) Points III-V (pp. 51-76).

To sustain the jurisdiction of this Court, appellant contends:

> *First.*—The judgment appealed from is a final judgment of the Supreme Court of North Carolina, which is the highest court in the State having jurisdiction of the case. The case drew in question

the validity, under the Federal Constitution, of the statute of North Carolina imposing the taxes in question, and the judgment of the State Court upheld the validity of the statute.

Second.—The statute of North Carolina has been construed to impose a tax upon 80% of appellant's income, while in fact only 17% of its income was derived from business or operations in the State of North Carolina. The statute as so construed is repugnant to the Federal Constitution.

Third.—The unconstitutionality of a state tax statute cannot be affected by a ruling of the State Court that evidence showing the unjust operation of the statute is immaterial.

The following decisions of this Court are believed to sustain jurisdiction of this appeal:

Fisk v. *Kansas*, 274 U. S. 380, 385;
Dahnke-Walker Milling Co. v. *Bondurant*, 257 U. S. 282;
Cudahy Co. v. *Parramore*, 263 U. S. 418, 422;
Kansas City So. Ry. Co. v. *Road Improvement Dist.*, 266 U. S. 379, 385;
Nashville, Chattanooga & St. Louis Ry. v. *White*, 278 U. S. 456;
Safe Deposit & Trust Co. of Baltimore v. *Virginia*, 280 U. S. 83.

Statement of Case.

This is an appeal from a final judgment of the Supreme Court of the State of North Carolina, affirming the judgment of the Superior Court for Buncombe County, entered after a trial before the Court, without a jury.

The action was brought to recover taxes assessed under the North Carolina income tax laws of 1923 and 1925, on the ground that said laws as construed and applied to the appellant were repugnant to the Federal Constitution. The appellant filed returns and paid certain taxes shown to be due thereon for the years 1923, 1924, and 1925, voluntarily and without protest. Thereafter, the Commissioner of Revenue audited the returns for these three years, and assessed additional taxes. The appellant paid these additional taxes for these three years and the entire taxes for 1926 under protest, and thereafter took an appeal for the recovery of the entire taxes paid for the four years.

As to the taxes paid without protest appellant acquiesces in the decision of the State Court that recovery is barred through failure to protest (R. 166). As to the taxes paid under protest it is not questioned that appellant has exhausted by due and timely proceedings all the legal and administrative remedies provided by the state statutes and procedure. There is no technical question of procedure. The sole question is whether these taxes were illegally assessed and collected. The taxes paid under protest are as follows:

For the year 1923	$2,124.65
" " " 1924	1,536.77
" " " 1925	444.11
" " " 1926	3,651.46
A total of	$7,756.99

The taxes for 1923 and 1924 were assessed under Section 201, Chapter 4, of the Public Laws of 1923 of North Carolina; and the taxes for 1925 and 1926 were assessed under Section 201, Chapter 101 of the Public Laws of 1925 of North Carolina. The statutes are printed in the margin. (1)

The statutes provide for an apportionment of income on the inflexible basis of location of tangible property owned. All other factors are disregarded. This case presents the question, heretofore expressly left undecided by this Court, whether such a statute is arbitrary and unconstitutional when the record shows that it results in fact in an unreasonable and unjust tax, and imposes a burden upon a much larger percentage of income than in fact had its source in the State.

Appellant is a New York corporation, having its principal office in New York City, where is located its sole sales office and where it also rents and operates a factory and warehouse. It also owns and operates a tannery in Asheville, North Carolina. Most of its manufacturing is done in North Carolina. All of its selling, all of its financial operations, and a part of its manufacturing are con-

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(1) SEC. 201 OF CHAP. 4, OF THE LAWS OF 1923.

"Every corporation organized under the laws of this state shall pay annually an income tax, equivalent to three per cent of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this state shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income to be determined according to the following rules:

"In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, sale, or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this state on the date of the close of the fiscal year of such company in the income year is to the fair cash

ducted in New York. The appellant does not deny that the State of North Carolina has jurisdiction to impose an income tax against it for that portion of its total income which was derived from its operations in North Carolina. The question presented by this appeal is whether the statutory rule for the apportionment of income, as it has been construed and applied to the appellant, is repugnant to the Fourteenth Amendment and the Commerce Clause of Section 8 of Article One of the Federal Constitution.

There is no dispute as to the amount of appellant's gross or net income nor that the computation of the tax was made in conformity to the statute.

Applying the statute, the North Carolina authorities have apportioned an average of eighty per cent. (80%) of the corporation's income as having its source in North Carolina, and have imposed a tax upon that amount of income. The appellant contends that only an average of

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value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

"In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this state for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the state."

SEC. 201 OF CHAP. 101 OF THE LAWS OF 1925.

"Every corporation organized under the laws of this state shall pay annually an income tax, equivalent to four per cent of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this state shall pay annually an income tax equivalent to four per cent of a proportion of its entire income to be determined according to the following rules:

"(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible (personal) property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this state on

seventeen per cent. (17%) of its income had its source in the company's operations in North Carolina, that the remainder of the income was derived from operations without the State, and that therefore the application of the statutory rule of apportionment to it is arbitrary and repugnant to the Constitution.[2]

At the trial in the Superior Court appellant introduced evidence, without objection as to its form or competency, showing the nature and character of its business, and an analysis of its accounts and the sources of its profits in support of its contention that only 17% of its income was derived from North Carolina sources, or was subject to tax by that State (R. 94-151). At the conclusion of the case the trial court struck out all of appellant's evidence as immaterial, and holding that the statute was not unconstitutional on its face, gave judgment against the appellant (R. 151). This excluded evidence is embodied in

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the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of incumbrances thereon.

"(b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this state for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the state.

"(c) The words 'tangible personal property' shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money deposits in bank, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt."

(d) (Relating to foreign insurance companies, omitted.)

[2] The original petition for review alleged that less than 25% of the income had its source in North Carolina. Appellant's direct evidence was to the effect that only 17% had its source in that State. Upon another theory of computation, 21.7% of the income was derived from North Carolina operations. In its opinion the State Supreme Court assumed that the evidence established 17%.

the record before the State Supreme Court and in the record on appeal here. In the State Supreme Court the action of the trial court in striking out all of appellant's evidence as immaterial was urged as error, upon the ground that the constitutionality of the statute could only be determined in the light of its practical application to appellant (R. 152).

The State Supreme Court held that the statute was not unconstitutional on its face (R. 161); and assuming that the excluded evidence established that only 17% of the income in fact had its source in the operations in North Carolina (R. 164), held the exclusion of that evidence was not error (R. 165), apparently upon the ground that in view of the general character of appellant's business, evidence showing that the statutory apportionment resulted in an unjust tax in fact was not admissible.

The constitutional question presented on this appeal, therefore, is whether a state statute construed to impose a tax upon 80% of a foreign corporation's income, when in fact only 17% of its income is derived from operations in that state, is valid. Affecting this constitutional question is the primary question, whether appellant's evidence established in fact that the statutory allocation of income was arbitrary and unreasonable as applied to it, and the procedural question as to whether it was error to strike out this evidence as immaterial.

Specification of Errors.

1. The Supreme Court of the State of North Carolina erred in refusing to find Section 201, Chapter 4 of the Public Laws of North Carolina, Session of 1923, and Section 201, Chapter 101 of the Public Laws of North Carolina, Session of 1925, unconstitutional and repugnant to Section one of the Fourteenth Amendment to the Constitution of the United States, because, as construed and applied to this appellant, they result in a taking of its property without due process of law and deprive it of the equal protection of the laws by imposing arbitrary and unreasonable taxes on it.

2. The Supreme Court of the State of North Carolina erred in refusing to find Section 201, Chapter 4 of the Public Laws of North Carolina, Session of 1923, and Section 201, Chapter 101 of the Public Laws of North Carolina, Session of 1925, unconstitutional and repugnant to the Commerce Clause of Section 8 of Article I of the Constitution of the United States, because, as construed and applied to appellant, they result in the imposition of a tax which is an invalid burden upon appellant's interstate commerce.

3. The Supreme Court of North Carolina erred in holding the taxes imposed upon appellant were constitutional and were not repugnant to the Commerce Clause of Section 8 of Article I and Section One of the Fourteenth Amendment to the Constitution of the United States.

4. The Supreme Court of the State of North Carolina erred in affirming the judgment of the Superior Court, and in refusing to reverse said judgment upon the ground

that said Superior Court erred in striking out all of appellant's evidence as to the character of its business and the sources of its income as immaterial.

5. The Supreme Court of the State of North Carolina erred in holding that, although appellant had been taxed on 80% of its income, evidence tending to show that only 17% of its income came from its operations in North Carolina was immaterial.

6. The Supreme Court of the State of North Carolina erred in rendering the final judgment or decree against the appellant upon the 16th day of June, 1930, in the above entitled cause.

Summary of Argument.

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1. The record, including the evidence stricken out as immaterial, shows that in fact the taxes assessed on appellant are unjust and that an unreasonable part of its income has been apportioned as having its source in North Carolina 18

2. The order striking from the record as immaterial all of appellant's evidence was reversible error ... 33

(a) A taxpayer who questions the constitutionality of a taxing statute must show the application of the statute to himself, and that it operates unjustly as to him. In the absence of such showing, the Court will decline to consider the constitutionality of the statute. Therefore, evidence showing the facts of appellant's business and the unfair application of the statute to it was not immaterial, but was a necessary part of appellant's case. The order striking out that evidence was error.

Underwood Typewriter Co. v. *Chamberlain*, 254 U. S. 113;

American Manufacturing Co. v. *St. Louis*, 250 U. S. 459;

Dahnke-Walker Milling Co. v. *Bondurant*, 257 U. S. 282.

(b) Whether such error was a sufficient ground for reversal depends upon whether it might have changed the result of the case.

Judicial Code, 269; 28 U. S. C. A. 391;

Liberty Oil Co. v. *Condon Bank*, 260 U. S. 235;

Camp v. *Gress*, 250 U. S. 308.

(c) The State Court has misapprehended the "unity of use" or "unified business" rule as applied by this Court. It is not an arbitrary

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rule to sustain the constitutionality of state statutes, but is an application of the familiar rule that tax questions are determined on matters of substance and not of form.

Fargo v. *Hart*, 193 U. S. 490;
Oklahoma v. *Wells Fargo*, 223 U. S. 298;
Illinois Central R. R. v. *Greene*, 244 U. S. 555;
Union Tank Line v. *Wright*, 249 U. S. 275;
Southern Railway v. *Kentucky*, 274 U. S. 76;
Adams Express Co. v. *Ohio*, 165 U. S. 194;
Underwood Typewriter Co. v. *Chamberlain*, 254 U. S. 113;
Bass, Ratcliff & Gretton v. *State Tax Commission*, 266 U. S. 271.

(d) The exclusion of evidence showing that in fact only 17% of appellant's income came from sources in North Carolina was reversible error.

3. On the merits, the statute, construed as imposing a tax on 80% of appellant's income, while in fact only 17% of the income is earned in the State, is unconstitutional because:

(a) It is repugnant to the due process clause of the Fourteenth Amendment 51

(1) Taxation by a state of persons, property or business without its taxing jurisdiction is invalid under the due process clause.

State Tax on Foreign Held Bonds, 15 Wall. 300;
New York, Lake Erie & Western v. *Pa.*, 153 U. S. 628;
Union Refrigerator Transit Co. v. *Kentucky*, 199 U. S. 194;
Union Tank Line v. *Wright*, 249 U. S. 275;
Oklahoma v. *Wells Fargo*, 223 U. S. 298.

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(2) An income tax is no exception to this rule. As to it there must be jurisdiction to tax either the recipient or the source.

State Tax on Foreign Held Bonds, 15 Wall. 300;
Alpha Portland Cement Co. v. *Mass.*, 268 U. S. 203;
Shaffer v. *Carter*, 252 U. S. 37;
St. Louis v. *Ferry Co.*, 11 Wall. 423.

(3) North Carolina has no personal jurisdiction over appellant, a foreign corporation, and its jurisdiction to impose an income tax against appellant rests upon jurisdiction to tax the source of the income. Necessarily, therefore, jurisdiction to impose an income tax is limited to that part of the income which has its source in the taxing state.

Shaffer v. *Carter*, 252 U. S. 37;
The Yale and Towne Mfg. Co. v. *Travis*, 252 U. S. 60.

(4) A statutory allocation of income which is arbitrary and likely to subject to tax income which does not have its source in the State is invalid as to a corporation which is in fact unjustly taxed.

Gast Realty Co. v. *Schneider Granite Co.*, 240 U. S. 55, 59.

(5) The North Carolina statute allocates income on the location of tangible property owned, and disregards all other factors affecting the source of income such as the location of tangible property used but rented and not owned and the location of intangible property and the character of use.

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In former cases this Court has declined to decide whether such an allocation is arbitrary and invalid upon the ground that the taxpayer had failed to show that the statute in fact worked an unjust result as to him.

Underwood Typewriter Co. v. *Chamberlain*, 254 U. S. 113;

Bass Ratcliff & Gretton v. *State Tax Commission*, 266 U. S. 271.

(6) The arbitrary character of the statute appears from the fact that:

It taxes 80% of the income when only 17% came from the State.

It includes dividends and interest received from sources without the State in the total of apportionable income, but excludes the capital value of these securities in the apportionment of assets thus directly subjecting to tax income that is without the jurisdiction of the State.

If doing the same business appellant owned its New York factory and rented its North Carolina factory the income allocated to North Carolina would be decreased 50%.

It ignores the fact that the major part of appellant's profits come from a retail merchandising business conducted from the New York office.

It is contrary to general business experience in its assumption that profits are directly or chiefly dependent on the physical location of tangible property.

(b) It is repugnant to the Commerce Clause of Section One of the Constitution 68

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A State cannot impose a tax which is a direct burden upon interstate commerce.

Crew Levick Co. v. *Penn.*, 245 U. S. 292;
Kansas City Ry. Co. v. *Botkin*, 240 U. S. 227;
U. S. Express Co. v. *Minnesota*, 223 U. S. 335;
Galveston Railway Co. v. *Texas*, 210 U. S. 217.

A State having personal jurisdiction over a taxpayer can impose a general income tax on him including in the measure of the tax income derived from interstate commerce.

U. S. Glue Co. v. *Oak Creek*, 247 U. S. 321;
Peck & Co. v. *Lowe*, 247 U. S. 165.

But where a State's tax jurisdiction is based on jurisdiction over the source a tax on income not having its source in the State but in foreign and interstate commerce is a direct burden on such commerce and is invalid under the commerce clause.

Alpha Portland Cement Co. v. *Mass.*, 268 U. S. 203;
International Paper Co. v. *Mass.*, 246 U. S. 135;
Looney v. *Crane*, 245 U. S. 178;
Fargo v. *Hart*, 193 U. S. 490;
Oklahoma v. *Wells Fargo Co.*, 223 U. S. 298;
Pollock v. *Farmers Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601.

(c) It is repugnant to the equal protection clause of the Fourteenth Amendment 71

The statute makes an arbitrary classification of corporations. The income of those

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dealing in tangible property is allocated on one basis, and that of those dealing in other property on another basis. This classification has no reasonable basis and as to those that suffer thereby the statute is invalid under the equal protection clause of the Fourteenth Amendment.

Gast Realty Co. v. *Schneider Granite Co.*, 240 U. S. 55;

Air-Way Elec. Co. v. *Day*, 266 U. S. 71;

Louisville Gas & Electric Co. v. *Coleman*, 277 U. S. 32;

Quaker City Cab Co. v. *Pennsylvania*, 277 U. S. 389.

ARGUMENT.

POINT I.

The record, including the evidence stricken out as immaterial, shows that in fact the taxes assessed on appellant are unjust, and that an unreasonable part of its income has been apportioned as having its source in North Carolina.

Appellant's total net income and the amounts apportioned to its North Carolina operations under the statutory rule are as follows (R. 15, 16, 32):

Year	Total Net Income	Net Income Apportioned to North Carolina	Total Tax	Percentage of Total Income Taxed
1923	$231,927.90	$194,123.65	$5,823.61	83.7
1924	257,881.70	221,494.59	6,644.84	85.89
1925	146,561.43	97,217.13	3,888.64	66.32
1926	106,727.55	91,286.49	3,651.46	85.53226
Average percentage taxed by North Carolina ...				80.38

The evidence which appellant contends establishes in fact that only 17% of its income was derived from North Carolina sources is summarized as follows:

Appellant is a New York corporation. Its business is that of tanning and manufacturing and selling leather. Its headquarters are in New York City, where it maintains its executive offices, sales offices, a cutting plant, a manufacturing plant, and warehouses (R. 97-100, 102, 103, 109, 110, 118). The New York real estate is rented and not owned (R. 145-151). It owns and operates a tannery at Asheville, North Carolina (R. 96). It also owns some timber land in North Carolina, carried at a value of $40,000 on its books, which is held as a reserve bark supply.

No use was made of this land during the years in question, and its ownership represented entirely an expense item for taxes and foresters (R. 97-98). Its bank accounts in New York average from $50,000 to $100,000. Its bank accounts in North Carolina average from $2,000 to $3,000.

The company owns stock in two corporations having no relation to North Carolina valued at $24,500 (in 1926 it was $27,200) (R. pp. 14, 21, 23, 29, 30). It received dividends on these stocks amouting to $904 in 1923 and 1924, and $804 in 1926 (R. pp. 10, 18, 32). These dividends were included in total apportionable net income, but the value of the stocks was disregarded in the allocation of assets. In 1926 it also received interest of $1,796.63 (p. 32) which was included in total taxable income although the securities producing the income were excluded in the allocation of assets.

Appellant's customers are located throughout various parts of the United States, Canada, and Europe (R. 98). It purchases its hides in Chicago and other western packing centers, and pays for them on sight drafts, the hides being shipped by the packers direct to the tannery at Asheville (R. 98). A portion of its tanning materials is purchased in North Carolina; and the other materials are purchased in the New York market, chiefly quebracho and cod oil. These materials are also shipped to the tannery (R. 99). The only sales office is located at New York City (R. 100). The traveling salesmen representing the Company travel throughout the country and report to the New York office. When an order is received for a sale, it is filled from New York stock if they have it in hand there; and if not, a requisition is sent by New York to the tannery at Asheville to fill the order (R. 101). An attempt is always made to keep stock to meet the requirements of the customers in the New York ware-

house (R. 110). All of the invoices for sales are made out in New York, and all payments are made to New York (R. 103). The North Carolina business is essentially manufacturing. With average sales of approximately $2,500,000, less than an average of $7,000 was sold to customers in the State of North Carolina (R. 134).

In each year appellant paid property taxes on the property owned in North Carolina, and also franchise taxes for the privilege of doing business in North Carolina. The amounts of these taxes were as follows (R. 138):

Year	Property Taxes	Franchise Taxes
1923	$18,276.52	$ 772.70
1924	16,152.97	723.20
1925	19,652.84	1,052.69
1926	22,170.00	1,052.69

The North Carolina corporation income tax is not a commutation tax or levied in lieu of property or franchise taxes. The State's position on this point was stated in the brief of the Attorney General in the State Supreme Court, as follows:

> "The income tax in North Carolina is in no sense a tax for the privilege of doing business in the state, nor does the statute anywhere deprive one of the privilege of doing business from failure to pay the tax. This indeed as the statute shows it to be, is a tax upon the net income earned in the state."

While the major part of the manufacturing is carried on at Asheville, a substantial part is also done in New York (R. 103). Much of the finishing of the leather and the cutting it up to meet special requirements is done at the New York factory.

Appellant's business is divided into two parts,—wholesale and retail (R. 108, 109). On the wholesale side, ship-

ments are made in carload lots in direct competition with other tanners and at established wholesale prices for leather. Generally speaking, the wholesale business is shipped direct from the tannery to the customers on orders sent by the New York office (R. 101, 102, 104, 107).

In the retail part of the business, the leather is cut up into small pieces, and finished in particular ways, and supplied in small lots to meet the particular needs of individual customers. Few, if any, of the other tanners engage in this retail business. Essentially, this part of the business is a retail merchandising business, conducted from the New York office, and factory, and by the New York office (R. 101, 102, 106, 108).

The operations which together result in the Company's total net income can be divided into three major groups, —buying, manufacturing, selling. Practically all of the buying and substantially all of the selling takes place outside of North Carolina (R. pp. 98-103, 110, 113, 115, 134). Most of the manufacturing, but not all, takes place in the State of North Carolina (R. pp. 97, 103, 110).

Appellant's evidence consisted of an analysis of its accounts for the four years in question to determine the gross profit from these major divisions—buying, manufacturing, and selling, and an allocation of these profits between the retail and wholesale departments.

In the analysis of the source of appellant's income, the apportionment was, of course, of gross profits before the deduction of certain general overhead expenses required to reach net income. The gross income considered in the analysis is, therefore, greater than the net income to which the resulting apportionment percentage is applied as is shown in the following table:

Year	Total Net Income	Gross Profits
1923	$231,927.90	$ 400,413.80
1924	257,881.70	403,286.67
1925	146,561.43	322,274.87
1926	106,727.55	169,250.90
Total	$743,098.58	$1,295,226.24

(R. 15, 16, 32, 127, 128.)

These gross profits were strictly operating profits and did not include the income from investments elsewhere discussed which was however included in the total net income.

In separating the gross profits into its three sources—buying, manufacturing, and selling,—the existing classification between wholesale and retail business afforded an obvious and convenient starting point. The profits from the retail business which was exclusively conducted from New York obviously were much less attributable to North Carolina than was the case with the wholesale business. The profits from the wholesale business were in part attributable to the manufacturing in Asheville and in part to the selling in New York. But the Company's accountants made no attempt to separate this. The entire wholesale profit was credited to manufacturing and allocated to North Carolina. Similarly, no attempt was made to allocate profits from manufacturing in New York from profits from manufacturing in Asheville. All manufacturing profits were allocated to North Carolina.

The analysis of appellant's accounts, therefore, sought to segregate (1) the selling profit on retail sales, (2) the buying profit, and (3) the manufacturing profit.

Retail Merchandising or Selling Profit.

The different parts of a hide make leather of different quality; and they sell for different prices,—that is, the heads and bellies are inferior in quality and sell for a lower price than the centers and sides (R. 104, 111). There are published wholesale market quotations for these different assortments of leather. These quotations represent the daily prices received by tanners throughout the country for their leathers (R. 120). A comparison of these public market prices with the prices actually received by appellant showed that as to the leather which it sold at wholesale in competition with other tanners, it received rather less than the average market price; while as to the leather which it specially finished and sold at retail, it received considerably more than the market price. It is contended that this difference or surplus price after deducting the extra cost of this retail business is strictly a selling or merchandising profit, which is not attributable to operations in North Carolina. Making this statistical analysis, the following results are shown (R. 120, 121):

HEADS.

Year	Market Price	Price Appellant Received
1923	13¢	10.34¢
1924	12.5¢	9.6¢
1925	15¢	12.19¢
1926	16¢	14.61¢

BELLIES.

1923	24¢	19.95¢
1924	20.75¢	19.17¢
1925	24.5¢	23.02¢
1926	27¢	26.48¢

Heads and bellies are sold by appellant in carload lots at wholesale, and in competition with other tanners; and the above comparison of prices indicates that appellant does not receive a premium over market price based upon any special manufacturing conditions or quality. In contrast with these wholesale prices, the rest of the hide, which is commonly called the butt, is cut up by the appellant and sold at retail. In comparing the price received by appellant for its retail sales with the average market price for the same class of leather, the additional cost to the appellant of cutting up and finishing this leather was deducted from the price received, so that the two prices could be fairly comparable. After making that calculation, the following results appear (R. 122-124):

BUTTS.

Year	Market Price	Appellant's Price
1923	67.521¢	73.612¢
1924	55.25¢	64.007¢
1925	57.666¢	62.996¢
1926	55.866¢	61.891¢

The fact that on its wholesale business the appellant received a uniformly lower price for its product than the prevailing published market price justifies the conclusion that since it received a higher price than the market price on its retail sales, this was attributable entirely to its merchandising activities outside of North Carolina, and not to any special quality or other factor affecting the price of its leather. If the net excess of price received on its retail sales is multiplied by the number of pounds sold in each year, an approximate estimate of the merchandising profit in those years can be obtained. This merchandising profit so calculated for the four years was as follows:

1923	$184,796.70 (R. 127)
1924	252,970.90 (R. 126)
1925	167,065.92 (R. 125)
1926	195,204.22 (R. 124)

The selling profits as thus calculated are not the total gross profits of this retail business. In three of the four years the gross retail profits materially exceeded the calculated selling profits, and left a substantial sum to be crediting to buying and manufacturing (R. 128-129).

Year	Gross Profits, Retail Business	Allocated as Selling Profit	Balance to Buying and Manufacturing Profit
1923	$330,699.95	$184,796.70	$145,903.25
1924	304,578.55	252,970.90	51,607.65
1925	251,952.70	167,065.92	84,886.78
1926	133,468.60	195,204.22	Loss 61,735.62

Buying Profit.

Since the price of hides is such a large part of the total cost of the leather, and since that price fluctuates widely, the profit in the tanning business is materially affected by the skill with which hides are bought through the year. As is the case with leather, hides are sold on a published daily market (R. 130); and as the price of leather is in the long run governed by the average cost of hides, a comparison of the actual cost of appellant's hides with the average cost of hides of similar quality sold in the market during the year gives an approximate indication of the profit or loss fairly to be attributable to the company's hide buying operations, which are not at all conducted in North Carolina. These comparisons show the following results (R. 130-134):

Year	Market Price of Steer Hides	Appellant's Cost of Steer Hides	Market Price of Cow Hides	Appellant's Cost of Cow Hides
1923	16.75¢	14.80¢	13¢	15.64¢
1924	14.5¢	13.14¢	12¢	9.87¢
1925	16¢	15.44¢	14.75¢	14.35¢
1926	14¢	13.42¢	13¢	12.58¢

Multiplying these differences by the number of pounds purchased in the respective years shows total buying profits as follows:

1923	$57,264.22
1924	93,026.42
1925	31,928.49
1926	31,521.01

The gross profit of 1923 was arrived at by deducting a loss of $37,006.09, excess cost of cow hides, from a saving of $94,270.31 profit on the purchase of steer hides.

Manufacturing Profit.

If the buying and merchandising profits as thus calculated are substracted from the gross profits for the year, the remainder represents what we have called the manufacturing profit. While a portion of this manufacturing is done at the factory in New York, no attempt is made in the calculations to separate this item. This so-called manufacturing profit also includes the selling profit on the wholesale business. Nevertheless the entire so-called manufacturing profit as thus obtained is credited to operations in North Carolina. Making this calculation, the following results appear:

1923:

Gross profit retail sales (p. 129)		$330,699.95
Gross profit wholesale sales (p. 129)		69,713.85
A. Total gross profit		$400,413.80
Buying profit (*supra*)	$ 57,264.22	
Selling profit (*supra*)	184,796.70	
B. Total	$242,060.92	$242,060.92
Manufacturing profit (difference A and B)		$158,352.88

1924:

Gross profit retail sales (p. 128)		$304,578.55
Gross profit wholesale sales (p. 128)		98,708.12
A. Total gross profit		$403,286.67
Buying profit (*supra*)	$ 93,026.42	
Selling profit (*supra*)	252,970.90	
B. Total	$345,997.32	$345,997.32
Manufacturing profit (difference A and B)		$ 57,289.35

1925:

Gross profit retail sales (p. 128)		$251,952.70
Gross profit wholesale sales (p. 128)		70,322.17
A. Total gross profit		$322,274.87
Buying profit (*supra*)	$ 31,928.49	
Selling profit (*supra*)	167,065.92	
B. Total	$198,994.41	$198,994.41
Manufacturing profit (difference A and B)		$123,280.46

1926:

Gross profit retail sales (p. 127)		$133,468.60
Gross profit wholesale sales (p. 127)		35,782.30
A. Total gross profit		$169,250.90
Buying profit (*supra*)	$ 31,521.01	
Selling profit (*supra*)	195,204.22	
B. Total	$226,725.23	$226,725.23
Manufacturing loss (difference A and B)		$ 57,474.33

For the four years the totals and averages of this analysis, then are:

Total gross profits of	$1,295,226.21
Total buying profits of	$213,740.14 or 16.5%
Total selling profits of	800,037.74 or 61.8%
Total manufacturing profits of	281,448.36 or 21.7%

We have shown that net income was only about 60% of gross profits. For the four years North Carolina has allocated and taxed total net income of $604,121.86 while total gross profits earned in the State only amounted to $281,448.36, or less than half the amount of net income subjected to tax.

Since the evidence was undisputed that the buying of hides and the retail selling of the leather were neither in any respect North Carolina operations, this allocation of business and income indicates that the percentage of income attributable to North Carolina in no event exceeds 21.7%. If the manufacturing profit were further analyzed to separate the profit from New York manufacture and the part of wholesale profits attributable to selling effort outside the State the percentage of income fairly attributable to operations in North Carolina would be further reduced.

The accountant who testified carried the analysis of the sources of profits further than the above computation. The method of the calculation does not appear in detail in the condensed statement of the testimony. In general, it represented an attempt to compute the manufacturing profit independently and not as a remainder of gross profit after deducting the sums definitely allocated as buying and retail selling profits. It was based on a comparison of the actual cost of appellant's leather with what it could have purchased the same leather for in the open market.

On this direct computation the manufacturing profit was:

For 1923	$145,903.25 or 37%	(p. 137)
" 1924	51,607.65 or 13%	(p. 136)
" 1925	84,866.88 or 26%	(p. 136)
" 1926 (Loss) ...	61,735.62	(R. 135)

An average of 17% of gross profits derived from tanning and manufacturing operations. This is the allocation assumed to be established by the evidence by the Supreme Court of North Carolina in its opinion upholding the constitutional validity of the tax (R. 164).

So far as the issue of this appeal is concerned, it seems unnecessary to determine whether the average percentage of income earned in the State is 17% or 21.7%. Under the statute the appellant has been taxed on an allocated percentage of 80% of income. If the tax is illegal on an actual apportionment of 17%, it is equally illegal on an actual apportionment of 21.7%.

The substantial accuracy of appellant's apportionment of income and the claim that only a relatively small part thereof can be fairly attributed to the manufacturing operations in the State, is confirmed by other evidence.

In 1919 the appellant purchased 355,488 pounds of leather in the open market, which it cut up and sold at retail. It also tanned a considerable quantity of similar leather, which it sold in the same way. It made a profit of 22.26¢ a pound on the leather which it purchased, and only 13.57¢ a pound profit on the leather sold of its own tannage. In that year the evidence is thus clear that its entire profit was in the retail selling of the leather, and that its manufacturing operations resulted in an actual loss. While the tax for this year is not in controversy, the actual facts of that year are pertinent as to the accounting accuracy of appellant's apportionment theory in the years here in question (p. 119).

At certain times in this industry there is a custom of "tanning contracts." Under such contracts a tanner, who for any reason is not in a position to tan and merchandise his own leather, agrees to tan hides for others at a fixed price per pound. In a given year these tanning contracts are substantially uniform in price. In three of the years here in question appellant could have had its leather tanned for it by others under these tanning contracts. A comparison of these tanning contract prices with what it actually cost appellant to tan its own leather shows that in two years it cost it more to tan its own leather than it would have cost under a tanning contract; while in one year its actual cost was less than it would have been under a tanning contract (pp. 107, 108, 114, 129, 130). The actual figures are:

Year	Pounds of Leather Tanned	Contract Cost Per Pound	Appellant's Actual Cost Per Pound	Difference Manufacturing Cost
1923	5,091,311	14½¢	13.95¢	$28,002.21
1925	4,796,036	12¢	13.67¢	80,093.80
1926	5,299,637	12¢	13.84¢	97,513.32

These figures indicate that the manufacturing profit should have been relatively large in 1923, and small in 1925 and 1926. The computed manufacturing profit in those years (*supra*) was:

In 1923	$145,903.25
" 1925	84,866.88
" 1926 (Loss)	61,735.62

The computed figures therefore conform generally to the results that the "tanning contract" comparisons would indicate.

Most of the other tanners in the country do exclusively a wholesale business. A comparison of the net profits on investment and on total sales realized by appellant with that of other large tanners who do not engage in retail selling shows that the appellant's rate of profit was much higher than that of other tanners. This again corroborates its computation that allocates the main profits of the business to its special selling effort. These comparative figures are:

In 1923 and 1924 the Central Leather Company, with assets of $107,271,766.56, had a net loss, and in 1925 a profit of 2¾% on its investment, and in 1926 a profit of 1.6% on its investment. For the four-year period it earned a little less than nothing on its investment (p. 114).

In 1924 the National Leather Company, with assets of $28,365,474.67, had a profit return on investment of 3.4%; in 1925 a return of 2.8%; and in 1926 a net loss. The average return on investment for the three years was less than 2% (p. 114).

On the other hand, in 1923 appellant had a net return on its investment of 14.2%; in 1924 of 10.8%; in 1925 of 5.75%; and in 1926 of 4.37%; an average return for the four years of 9% on investment (pp. 134, 135).

The National Leather Company reported a profit on sales of 2.75% in 1925, and of 3.6% in 1924. These are the only available sales reports of other companies (p. 114). The appellant had a profit on sales in 1925 of 6% and in 1924 of 12% (pp. 134, 135).

A final check on appellant's allocation of profits is the ratio of profits to sales on the retail as compared to the wholesale end of the business. The retail sales show a much higher rate of profit, and this fact is further confirmation of the substance fact that the profits of the business are mostly earned outside of North Carolina. The comparative figures on this check are as follows:

Year	Per Cent. of Profit, Retail Sales	Per Cent. of Profit, Wholesale Sales
1923	17.39	10.91
1924	19.66	17.14
1925	15.29	9.97
1926	8.00	5.32
Average	15.09	10.82

(pp. 127-129)

The retail sales have a rate of profit about fifty per cent. higher than the wholesale sales.

We submit that the appellant's evidence that the Court below struck out as immaterial was clearly sufficient to establish that in actual fact the income derived from its operations in North Carolina was vastly less than that upon which it has been taxed under the statutory allocation here drawn in question.

POINT II.

The order striking out all of appellant's evidence as immaterial was reversible error.

At the conclusion of the trial in the Superior Court, that Court granted the State's motion to strike from the record all of appellant's testimony as immaterial; and the appellant duly excepted and urged that ruling as error on the appeal to the State Supreme Court. This error is also urged in the Assignments of Error in this Court. The appellant's evidence which was thus excluded has been summarized and analyzed in the preceding point.

Any objection as to the form of the evidence or as to the competency of the testimony of the various witnesses who testified to the facts introduced in evidence was expressly waived. The parties stipulated that the original books of the appellant need not be introduced in evidence as a foundation for the testimony of the witnesses based on said books, and that the State would not object to any testimony because those books were not introduced in evidence (R. pp. 95, 96). The sole objection to this evidence on the part of the State was that it was immaterial. The Court's action in striking out all of this evidence was expressly based upon the ground that the entire evidence was immaterial (R. pp. 151, 93).

This ruling was clearly erroneous, and the evidence was material. This was true for two reasons,—first, because the appellant cannot be heard to attack the constitutionality of the statute unless he shows that he is hurt by the alleged invalidity; and second, because the facts as to the application of the statute to the appellant are material

evidence on the fundamental question as to whether the statute is arbitrary or reasonable. While it may be that a court could say that a tax classification based upon the color of a man's hair was obviously inherently arbitrary, ordinarily the question of whether or not a statute is arbitrary and unconstitutional can only be determined by observing its application in particular cases. Therefore, appellant's evidence was material, not only for the purpose of showing that it was hurt and therefore in a position to attack the statute, but also as affording a certain measure of fact and of evidence by which the reasonableness of the statute could be tested. This rule is so well established in this Court, that it is unnecessary to cite many cases.

In *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113, the plaintiff attacked a Connecticut statute which was in many respects similar to the one here under consideration. The evidence offered by the Underwood Company did not attempt to show the actual sources of its income, and that company relied upon the contention that the statutory method of allocation was inherently arbitrary and therefore invalid. Under the statutory allocation, 47% of the Underwood Company's income was apportioned to Connecticut. In deciding against the Underwood Company's attack on the law, this Court said at page 121:

> "* * * for aught that appears the percentage of net profits earned in Connecticut may have been much larger than 47 per cent. There is, consequently, nothing in this record to show that the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result.

> "We have no occasion to consider whether the rule prescribed if applied under different conditions might be obnoxious to the Constitution."

In *American Mfg. Co.* v. *St. Louis*, 250 U. S. 459, the Court said at page 462:

> "But as has been held very often, the question of whether a state law or a tax imposed thereunder deprives a party of rights secured by the Federal Constitution depends not upon the form of the act, nor upon how it is construed or characterized by the state court, but upon its practical operation and effect."

In *Shaffer* v. *Carter*, 252 U. S. 37, the Court said at page 55:

> "For, where the question is whether a state taxing law contravenes rights secured by that instrument, the decision must depend not upon any mere question of form, construction, or definition, but upon the practical operation and effect of the tax imposed."

In *Dahnke-Walker Co.* v. *Bondurant*, 257 U. S. 282, the Court said:

> "A statute may be invalid as applied to one state of facts and yet valid as applied to another. Poindexter *v.* Greenhow, 114 U. S. 270, 295; St. Louis, Iron Mountain & Southern Ry. Co. *v.* Wynne, 224 U. S. 354; Kansas City Southern Ry. Co. *v.* Anderson, 233 U. S. 325. Besides, a litigant can be heard to question a statute's validity only when and so far as it is being or is about to be applied to his disadvantage. Yazoo & Mississippi Valley R. R. Co. *v.* Jackson Vinegar Co., 226 U. S. 217; Jeffrey Manufacturing Co. *v.* Blagg, 235 U. S. 571, 576."

While the order striking out all of appellant's evidence showing the practical application of the statute in question to it as immaterial was thus evidently error, appellant recognizes that such error is not ground for reversal unless it appears that it affected the result of the case.

> *Judicial Code*, Section 269; 28 U. S. C. A. 391; *Liberty Oil Co.* v. *Condon Bank*, 260 U. S. 235; *Camp* v. *Gress*, 250 U. S. 308.

Upon the appeal in the State Supreme Court, that Court in affirming the judgment held that the ruling of the trial court striking out appellant's evidence was not error, apparently upon the ground that considering the evidence as in the record, it would not change the result. After briefly reviewing the general character of appellant's evidence, the opinion of the State Supreme Court continued as follows:

> "Without burdening this opinion with detailed compilation set out in the record, the evidence offered by the petitioner tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent. Upon such evidence the petitioner earnestly contends that the taxing statute of North Carolina in its operation and application is unreasonable and arbitrary and hence repugnant to the Federal Constitution" (R. p. 164).

The State Supreme Court based its decision that the order striking out appellant's evidence was correct upon an interpretation of the unit rule, or the unitary business rule, and relied upon

Underwood Typewriter Co. v. *Chamberlain*, 254 U. S. 113;
Bass, Ratcliff & Gretton v. *State Tax Com.*, 266 U. S. 271;
Adams Express Co. v. *Ohio*, 165 U. S. 194.

The State Court apparently construed these cases as establishing that since in a unitary business a statutory rule of apportionment or valuation of one kind of property upon the basis of an assumed relationship to another kind of property may be valid, *in the absence of evidence that the statutory rule works injustice*, therefore evidence showing that in such business the statute works injustice in fact is inadmissible. In so doing, we submit that the State Supreme Court clearly erred and misinterpreted the decisions of this Court upon which it relied.

We have found twenty-three cases in this Court involving the constitutionality of a state statute in which an apportionment on the unitary business theory was used. These cases have considered different subjects of taxation and different rules of apportionment. But they all had one common factor. They imposed a tax upon a proportion of the corporation's total property or income or stock, that proportion being determined by the relation that some other and particular kind of property in the State bore to the total property of that kind wherever situated.

In none of these cases has it been held or suggested that evidence showing that the practical application of the statutory formula worked an injustice was immaterial. The State Court's conclusion that these cases support its decision that appellant's evidence was immaterial is wholly unfounded. On the contrary, in every case in

which the question has arisen, this Court has expressly recognized the materiality of this kind of evidence.

In six cases the Court has held a state apportionment statute unconstitutional on evidence showing that the statutory formula worked an unjust result on the particular facts of the complaining taxpayer.

In *Fargo* v. *Hart*, 193 U. S. 490, a tax was levied upon that proportion of the total property of the Express Company that the mileage operated in Indiana bore to the total mileage. The taxpayer introduced evidence showing that this statutory rule of apportionment based upon mileage was, as applied to it, unfair and resulted in a tax upon a greater amount of property than was in fact in the State or subject to the State's taxing jurisdiction. In holding that under the facts of the case the apportionment statute imposed an unconstitutional burden, this Court said:

> "And when that property is part of a system and has its actual uses only in connection with other parts of the system, that fact may be considered by the State in taxing, even though the other parts of the system are outside of the state * * *. This being clear, it is held reasonable and constitutional to get at the worth of such a line in the absence of anything more special, by a mileage proportion. The tax is a tax on property, not on the privilege of doing the business, but it is intended to reach the intangible value due to what we have called the organic relation of the property in the State to the whole system * * *.
>
> "It is obvious, however, that this notion of organic unity may be made a means of unlawfully taxing the privilege, or property outside the State, under the name of enhanced value or good will, if it is not closely confined to its true meaning."

In *Oklahoma* v. *Wells Fargo*, 223 U. S. 298, the tax was on that proportion of the total gross receipts of the company that the business done within the State bore to the whole of its business. A complaining taxpayer introduced evidence showing that its gross revenues included income from bonds and other property situated without the State; and on such evidence this Court held the statute unconstitutional as applied to this taxpayer on the authority of *Fargo* v. *Hart* (*supra*), as to which the Court said:

> "In that case the tax was proportioned to mileage and it was held that it could not be sustained, when, although purporting to be a tax on property, it took into account, in order to increase proportionately the value of the mileage within the State, valuable property outside of it. The same principle would apply to a property tax measuring the total property by the total gross receipts increased by the special outside sources of income and taxing a proportion of this total fixed by the ratio of business within the State to that outside."

In *Illinois Central Rd.* v. *Greene*, 244 U. S. 555, the tax was on an allocated proportion of the total capital stock. The statutory allocation was based upon the mileage in the State as compared to the total mileage. The taxpayer introduced evidence showing that upon the particular facts of this case the statutory allocation produced an unfair result; and on this evidence this Court held the statute invalid, the Court saying:

> "* * * a state cannot tax property outside of its jurisdiction belonging to persons domiciled elsewhere, and that although the fact that property is part of a system and has its actual uses only in connection with other parts of the system may be con-

sidered by the State in taxing that portion of the system which is within its borders, yet the notion of organic unity must not be made the means of unlawfully taxing property without the State."

In *Union Tank Line* v. *Wright*, 249 U. S. 275, the tax was on the value of the average number of cars in the State during the year. This value was reached by a statutory formula of allocation based on the proportion that the mileage in Georgia bore to the total mileage. The taxpayer showed that the application of this rule resulted in a valuation of its cars within the State of Georgia greatly in excess of their actual value. In holding the statutory rule of apportionment invalid upon this evidence, the Court said:

"A state may not tax property belonging to a foreign corporation which has never come within its borders—to do so under any formula would violate the due process clause of the 14th Amendment. In so far, however, as moveables are regularly and habitually used and employed therein, they may be taxed by the state according to their fair value * * *. While the valuation must be just it need not be limited to mere worth of the articles considered separately, but may include as well 'the tangible value due to what we have called the organic relation of the property in the state to the whole system.' How to appraise them fairly when the tangibles constitute part of a going concern operating in many states often presents grave difficulties; and absolute accuracy is generally impossible. We have accordingly sustained methods of appraisement producing results approximately correct—for example, the mileage basis in case of a telegraph company, and the average amount of property habitually brought in and carried out by a car company. But if the plan pursued is arbitrary

and the consequent valuation grossly excessive, it must be condemned because of conflict with the Commerce Clause or the Fourteenth Amendment or both * * *.

"We think the plaintiff-in-error's property was appraised according to an arbitrary method which produced results wholly unreasonable and that to permit enforcement of the proposed tax would deprive it of property without due process of law and also unduly burden interstate commerce * * *.

"In other opinions of this Court cited below to support the conclusion there reached we upheld the power of a state to tax property actually within its jurisdiction upon a fair valuation considered as part of a going concern—they give no sanction to arbitrary and inflated valuations. Taxes must follow realities; not mere deductions from inadequate or irrelevant data."

In *Wallace* v. *Hines*, 253 U. S. 66, there was involved an excise tax for the privilege of doing business in the State. The base was the total value of property apportioned in accordance with main line mileage in the State and elsewhere. In holding the statute bad upon evidence showing that the property outside was relatively more valuable than that in the State, the Court said:

"The only reason for allowing a state to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess. The purpose is not to expose the heel of the system to a mortal dart—not, in other words, to open to taxation what is not within the state. Therefore no property of such an interstate road situated elsewhere can be taken into account unless it can be

> seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the state. Hence the possession of bonds secured by mortgage of lands in other states, or of a land grant in another state or of other property that adds to the riches of the corporation but does not affect the North Dakota part of the road is no sufficient ground for the increase of the tax—whatever it may be—whether a tax on property, or, as here, an excise upon doing business in the State."

In *Southern Ry.* v. *Kentucky*, 274 U. S. 76, a franchise tax based upon the capitalization of net operating income was before the Court. Allocation of income was on the basis of mileage within and without the State, less the assessed value of tangible property. The Court discussed the application of the unit rule as made by it in other cases, and said:

> "The mileage used as an integral part of a railroad system may have elements of value that it otherwise would not possess, and the state properly may have regard to the whole in order to ascertain the value of the part that is within its borders. Fargo *v.* Hart, *supra*, 499. But if the method pursued in valuing property within the state is arbitrary and the resulting valuation is grossly excessive the tax must be condemned as in contravention of the due process clause of the 14th Amendment. Union Tank Line Co. *v.* Wright, *supra*, 282 and cases cited. It is not permissible for the state to take into account any of the outside property 'unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the state.' Wallace *v.* Hines, *supra*, 69."

After discussing the evidence showing the practical application of the statute and the rule of apportionment

to the facts in the case, the Court held the statute unconstitutional, saying:

> "The mere statement of the figures is sufficient to show that the amount added as a basis for franchise taxes is so excessive and unreasonable that it cannot be sustained."

The figures in this case upon which the Court based its decision showed that while the railroad as a whole produced satisfactory net profits, the lines in Kentucky were operated at a loss; and on this showing of fact the Court held the application of the unit rule was arbitrary and void. While this decision was not by a unanimous court, the dissenting opinion was expressly based, not on the merits, but on a failure to raise the objections properly in the Court below.

In five cases the Court has sustained a state apportionment statute on the express ground that the taxpayer had failed to prove that as applied to it the statutory formula worked unjustly.

In *Adams Express Co.* v. *Ohio*, 165 U. S. 194, and *Adams Express Co.* v. *Indiana*, 165 U. S. 255, state statutes imposing property taxes allocated in proportion to the length of lines over which the business was done within and without the State were upheld in cases which were elaborately argued and were decided by a divided court. In applying the unit of use rule, the Court said:

> "As to railroad, telegraph and sleeping car companies, engaged in interstate commerce, it has often been held by this court that their property, in the several States through which their lines or business extended, might be valued as a unit for the purposes of taxation, taking into consideration the uses to which it was put and all the elements making up

aggregate value, and that a proportion of the whole fairly and properly ascertained might be taxed by the particular State without violating any Federal restriction. * * *

"Doubtless there is a distinction between the property of railroad and telegraph companies and that of express companies. The physical unity existing in the former is lacking in the latter; but there is the same unity in the use of the entire property for the specific purpose, and there are the same elements of value arising from such use. * * *

"We repeat that while the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business."

But in approving the application of the statutory rule of apportionment in that case, the Court recognized that it was not an inflexible rule, but one to be applied only when appropriate under the facts shown in the particular case. Thus the Court said at page 227:

"Special circumstances might exist, as indicated in Pittsburgh, Cincinnati &c. Railway *v.* Backus, 154 U. S. 421, 443, which would require the value of a portion of the property of an express company to be deducted from the value of its plant as expressed by the sum total of its stock and bonds before any valuation by mileage could be properly arrived at, but the difficulty in the cases at bar is that there is no showing of any such separate and distinct property which should be deducted, and its existence is not to be assumed. It is for the companies to present any special circumstances which may exist, and, failing their doing so, the presumption

> is that all their property is directly devoted to their business, which being so, a fair distribution of its aggregate value would be upon the mileage basis."

In his dissenting opinion in this case, Mr. Justice WHITE clearly foreshadowed the subsequent decision of the Court upon one of the statutes there involved. At page 251 he said:

> "This court has effectually determined that where a corporation is engaged in interstate business, no one of the States has the power to tax the receipts of such company derived from interstate commerce business, and that the power of the States as to taxation on earnings is limited to those derived from the business done within the State. This line of concluded authority is illustrated and referred to in the recent opinion in Osborne *v.* Florida, 164 U. S. 650, decided at this term. It is, therefore manifest that where property owned in common, belonging to the same person and situated in different states, contributes to earnings, and the proceeds of these earnings go into the treasury of the owner, and lie side by side therein, that the fact that there is a common owner, that there is a common business, and that all the results of the business are in immediate contact in the common treasury, gives no power to the State to tax the whole, but only to levy on that which comes from the state business alone."

When in *Fargo* v. *Hart, supra,* the taxpayer introduced evidence showing that in fact under the same statute its practical application to it worked an injustice, the Court held the statute invalid. These two cases alone are sufficient to establish the materiality of appellant's evidence in this case at bar.

In *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (*supra*), the Court sustained a Connecticut tax upon the income of a foreign corporation apportioned, as here, upon the basis of tangible property within and without the State. In that case the taxpayer offered no evidence to show that the statutory rule of apportionment in fact operated unjustly upon it. The decision of the Court upholding the tax was expressly based upon the taxpayer's failure to show that the percentage of net profits actually earned in Connecticut was less than that allocated under the statutory formula. We have quoted from the opinion of this Court to this effect, *supra*, page 34.

In *Bass, Ratcliff & Gretton* v. *State Tax Com.*, 266 U. S. 271, the New York income tax upon a foreign corporation was involved. The tax was based upon an apportioned part of the total net income of the corporation. The statutory formula of apportionment took into account both tangible and intangible property within and without the State. The tax was sustained upon several grounds, one of which was that there was no evidence in the record that the income allocated to New York exceeded the net income actually earned from the business in that State. Not only was there no ruling in that case that evidence showing that the application of the statute was unjust or unreasonable would be immaterial, but the decision was expressly rested in part upon the ground that the company had failed to introduce such evidence.

In *Great Northern Railway* v. *Minnesota*, 278 U. S. 503, the tax was upon the gross earnings in lieu of all property taxes. The gross earnings were those from business wholly within the State, plus an allocated part of gross earnings from the interstate business, in the proportion of the mileage in the State to the total mileage. This case, therefore, involved a State tax on the local prop-

erty of a railroad company, in which the unit rule was invoked. The company attacked the assessment as violative of the Commerce Clause and of the Fourteenth Amendment upon the ground that the gross receipts included rents from docks located in Wisconsin. The Court sustained the tax upon the ground that the evidence did not show the actual use value of either part of the road or their relative values, and that if all the facts were shown, it was equally probable that the Minnesota tax would be too low as it was that it would be too high. The application of the unit rule was sustained upon the express ground that the record did not show affirmatively that it was unfair.

In *Pullman Co.* v. *Richardson*, 261 U. S. 330, the tax was measured by the gross receipts within the State, and these receipts in turn were based in part upon a mileage proportion within and without the State. There was no attempt made to show that the result was in fact unfair. The tax was imposed in lieu of all other taxes and was sustained as a reasonable property tax. It is not wholly clear whether the apportionment was sustained because of the failure of the taxpayer to introduce evidence showing that it worked an injustice, or whether this case falls in the next group of cases in which the fairness of the apportionment was not involved, and the attack on the statute was based upon other grounds.

In the remaining twelve cases, the justice or constitutionality of the apportionment formula was not involved or considered. In them, the question was whether the tax could be levied at all. These cases were

Western Union Telegraph Co. v. *Mass.*, 125 U. S. 530;

Pullman Palace Car Co. v. *Penna.*, 141 U. S. 18;
Pittsburgh Rd. v. *Backus*, 154 U. S. 421;
Henderson Bridge Co. v. *Kentucky*, 166 U. S. 150;
Amer. Refrigerator Transit Co. v. *Hall*, 174 U. S. 70;
Union Refrigerator Co. v. *Lynch*, 177 U. S. 149;
U. S. Express Co. v. *Minnesota*, 223 U. S. 335;
Louisville & Nashville Rd. v. *Greene*, 244 U. S. 522;
Cudahy Packing Co. v. *Minnesota*, 246 U. S. 450;
Hump Hairpin Mfg. Co. v. *Emmerson*, 258 U. S. 290;
National Leather Co. v. *Mass.*, 277 U. S. 413;
Western Cartridge Co. v. *Emmerson*, 281 U. S. 511.

In a few of these cases the opinion of the Court referred to the statutory formula based upon the unitary business theory as a fair method of apportionment; but where that was true, subsequent decisions of the Court showed that in these cases such a statement was obiter dictum, and that the question of the constitutionality of the apportionment formula was not in issue.

Thus, in *Western Union Co.* v. *Mass.*, 125 U. S. 530, the Court refers to the statutory apportionment on mileage as just and fair; but in Judge BRADLEY'S dissenting opinion in *Pullman Palace Car Co.* v. *Pennsylvania*, 141 U. S. 18, he said, with reference to the *Western Union* case, that some of the judges felt a doubt whether the statutory rule of value was valid, and he continued:

> "But the difficulty of getting at the true value of the property within the state and of adopting any other rule for ascertaining it, as well as the failure

of the company to show that the rule adopted produced any unfair results, finally induced an acquiescence in the decision."

Pullman Palace Car v. *Penn.*, 141 U. S. 18, is often cited as approving the statutory apportionment on the mileage basis. The fairness of that rule was not discussed in the opinion in that case; but in so far as the decision was in fact based upon an approval of the statutory formula, it was expressly overruled in *Union Tank Line* v. *Wright*, 249 U. S. 275.

We submit that these cases establish that the State Court erred in its interpretation of the unit rule, and that there is no authority holding that in a unitary business, evidence as to the practical application of a statutory rule of apportionment is inadmissible or immaterial.

But the State Court's conclusion on this point rested not only on an error of law, but also on an error of fact. It treated appellant's business as a unitary business within the meaning of that term as used in the foregoing decisions. In fact, the evidence shows appellant's business is not unitary, but consists of two distinct parts. The profits from the retail selling business conducted in New York have no direct or necessary connection with the manufacturing business conducted in North Carolina. In this respect this case is brought squarely within the terms of the exception made by the Court in

Adams Express Co. v. *Ohio*, 165 U. S. 194,

where the Court said:

> "The same party may own a manufacturing establishment in one State and a store in another, and may make profit by operating the two, but the work of each is separate. The value of the factory

> in itself is not conditioned on that of the store or *vice versa*, nor is the value of the goods manufactured and sold affected thereby. The connection between the two is merely accidental and growing out of the unity of ownership."

Applying this rule, we can correctly say that the profits of the New York retail business are not conditioned on the value of the Asheville factory.

Looking, then, at substance and not at form, at realities and not at legal fiction, the question whether or not the order striking out all of appellant's evidence was reversible error depends upon two questions:

> 1st.—Did appellant's evidence show that in fact the taxes assessed against it were unjust, and that an unreasonable part of its income was apportioned as having its source in North Carolina?

We have discussed this evidence in detail in the preceding point, and have shown that the answer to this question must be in the affirmative.

> 2nd.—Is a state statute construed to impose a tax upon eighty per cent. (80%) of the income of a foreign corporation, while in fact only seventeen per cent. (17%) of the income had its source within the State, an unconstitutional statute?

In the following points we show why we submit that the answer to this question must also be in the affirmative.

If the answer to these two questions is in the affirmative, then we submit that the judgment of the State Court should be reversed upon the ground of error in striking out appellant's evidence.

POINT III.

The North Carolina Revenue Acts of 1923 and 1925 as construed and applied to appellant are invalid and unconstitutional because repugnant to the Fourteenth Amendment to the Federal Constitution as depriving appellant of its property without due process of law.

That taxation by a state of persons or property outside its jurisdiction and within the jurisdiction of another state constitutes a taking of property without due process of law is "firmly established" (216 U. S. 1); "has been repeatedly held by this Court" (199 U. S. 194); "No principle is better established" (153 U. S. 628).

Cleveland, etc., Company v. *Pa.* (State Tax on Foreign Held Bonds), 15 Wall. 300;
New York, Lake Erie & Western v. *Pa.*, 153 U. S. 628;
Union Refrigerator Transit Co. v. *Kentucky*, 199 U. S. 194;
Western Union v. *Kansas*, 216 U. S. 1;
Delaware, Lackawanna, etc., Co. v. *Pa.*, 198 U. S. 341;
Dewey v. *Des Moines*, 173 U. S. 193.

An income tax is no exception to this rule. Strictly speaking, income as such has no real separate existence. It is merely an attribute either of the recipient or of the source. An income tax must be either a tax on the recipient of the income or on the source of the income. And from a constitutional standpoint the validity of an income tax depends primarily on jurisdiction over either one or the other of these subjects of taxation.

This was directly held by this Court in *Cleveland, etc., Co.* v. *Pa.* (State Tax on Foreign Held Bonds), *supra*, where the Court held a Pennsylvania income tax attempted to be imposed against foreign holders of the bonds of a Pennsylvania corporation was invalid, because lacking in jurisdiction over a taxable subject.

This case has not been overruled and has been much cited. The *ratio decidendi* of *Alpha Portland Cement Co.* v. *Massachusetts*, 268 U. S. 203, is in conformity with this rule. In that case the tax was in two distinct parts,—one on a portion of income, and the other a tax on what was called corporate excess. The tax was attacked on the ground that there was no jurisdiction in the State to tax either. The Court considered the tax as an excise for the doing of business, and held it unconstitutional. But it is well settled that in passing on the constitutionality of a state tax, this Court will disregard matters of definition or form. If in that case there had been jurisdiction to tax the income, that portion of the tax would have been sustained, regardless of whether it was defined as an excise or an income tax. *Shaffer* v. *Carter*, 252 U. S. 37.

We repeat that the tax here in question is not a franchise or privilege tax measured by income but is a direct income tax (*supra* fn. 7, 20). There is therefore not here involved the question discussed in *Educational Films Corporation* v. *Ward*, decided by this Court January 12, 1931 and not yet reported, of the distinction between the subject and the measure of a tax. It seems clear that in this case if there is a lack of jurisdiction to tax the income directly, the tax cannot be sustained as upon some other subject with the exempt income used merely as a measure.

In the case at bar North Carolina has no jurisdiction over the person of the appellant, a New York corpora-

tion. It cannot lawfully tax it on its entire income regardless of its source. This is clear both by reason and by authority. For example, in *St. Louis* v. *Ferry Co.*, 11 Wall. 423, at page 430, this Court said:

> "Where there is jurisdiction neither as to person nor property, the imposition of a tax would be *ultra vires* and void. If the legislature of a State should enact that the citizens or property of another State or country should be taxed in the same manner as the persons and property within its own limits and subject to its authority, or in any other manner whatsoever, such a law would be as much a nullity as if in conflict with the most explicit constitutional inhibition. Jurisdiction is as necessary to valid legislative as to valid judicial action."

If it be assumed that North Carolina had the power to impose an income tax on the entire income of a foreign corporation, the result would lead to an absurdity that would prove the assumption fallacious.

If North Carolina could impose a tax on the entire income of a corporation, doing business in each of the forty-eight States of the Union, so could each of the other States. If we assume an income tax rate of 5%, that would mean that the forty-eight States could impose an income tax aggregating 240% of the corporation's total net income. That the law would not tolerate any such absurd result is obvious. The State cannot lawfully tax a foreign corporation on its entire income, regardless of the amount of income having its source in the taxing State. This limitation was recognized by the Legislature in enacting the statute in question. Under that statute a domestic corporation is taxed on its entire income; a foreign corporation only upon an allocated portion.

Since, then, the State cannot lawfully tax all of the income of a foreign corporation in every case, what is the limit of the State's power and the State's jurisdiction?

In the case of a resident and citizen of the State, the State can tax all of the income regardless of its source as the statute in question does to the citizens and corporations of North Carolina; but if it cannot tax all of the income of a non-resident, it seems clear that the limit of its jurisdiction is to tax that part of the income which has its source in the taxing State. The State has jurisdiction to tax the source, and, therefore, can properly tax the income flowing from that source. That was the point of the decisions in *Shaffer* v. *Carter*, 252 U. S. 37, and *The Yale & Towne Mfg. Co.* v. *Travis*, 252 U. S. 60. In those cases the power of the State to impose an income tax upon a non-resident at all was challenged upon the ground that an income tax was ordinarily a personal tax, and that as the State had no jurisdiction to impose a personal tax against a non-resident, it could not impose an income tax upon him at all. But the Court held that in so far as the income was derived from sources within the State, the State had the power to tax the source; and since it had the power to tax the source, it could properly tax the fruit—that is, the income. It is a necessary corollary of that case that the jurisdiction of the State of North Carolina in the case at bar to tax the appellant's income is limited to a tax on that part of the income having its source in North Carolina.

The appellant concedes that taxation is not an exact science, and that in the case of corporations doing business in many States an allocation of net income as to source with mathematical accuracy is impracticable and is not required. In such cases the constitutional rule is satisfied if the statute establishes a rule of allocation

which reaches an approximately true result. If the statute prescribes a rule of allocation, on the other hand, which is arbitrary and which is likely frequently to produce incorrect and false results, then the statute is unconstitutional and void as to a corporation which is in fact unjustly taxed.

Gast Realty Co. v. *Schneider Granite Co.*, 240 U. S. 55, 59.

That is the question in this case. Is the method of allocation of income provided in the statute a reasonable one naturally producing an approximately correct allocation of income according to its source, or an arbitrary rule which disregards realities and imposes a tax on subjects beyond the State's jurisdiction? The unjust result in the case at bar is persuasive evidence of the arbitrary character of the statutory allocation. If a consideration of the statute shows that unjust results are likely to follow in other cases, then the unjust result in the case at bar clearly entitles appellant to relief.

We correct one misapprehension of the State Supreme Court as expressed in its opinion. It says "The petitioning taxpayer, apparently conceding in its brief that the statute is constitutional upon its face, contends that the execution thereof and the application thereof to its business works out an unreasonable and highly arbitrary result and thus effects a denial of its constitutional rights" (R. p. 162). Appellant's concession was not that the statute was constitutional but that it could not be heard to question the constitutionality without showing that the statute worked an unreasonable result as to it.

The statutory rule of allocation is simple. It directs that income shall be allocated in proportion to the location of tangible assets owned. It expressly excludes from

the equation and from the allocation any consideration of receivables, stocks, or bonds, or other intangible assets. It excludes from consideration tangible property used but rented and not owned. It excludes from the calculation any consideration of the character of the business transacted or of the actual sources of income. The appellant says that that rule is arbitrary and as to it invalid. The question of the reasonableness of this basis of allocation has not been finally decided by the courts. It has only been directly considered in one case.

In *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113, a Connecticut tax statute was challenged in which the rule of allocation was the same as the North Carolina statute here involved. It appeared in that case that the plaintiff's factories were located in Connecticut, and that all of its manufacturing was done in that State, while most of its selling was done outside of Connecticut. Forty-seven per cent. of its tangible assets were located in Connecticut, and fifty-three per cent. outside of Connecticut, so that Connecticut allocated to the corporation forty-seven per cent. of its net income. The corporation made no attempt to analyze its business and to show what in fact was the income having its source in Connecticut in its manufacturing operations, and what in its selling business outside of Connecticut. In its brief and argument the Underwood Company contended that its income flowed exclusively from its sales, and that the manufacturing business conducted by it could have no relation whatever to its income or profits. This contention was made *a priori* and with no analysis of the business. In deciding the case the Court held that the record failed to show that in fact less than forty-seven per cent. of the corporation's income was fairly attributable to the manufacturing business in the State, and since the appellant

in that case had failed to show that it was unfairly taxed, it was not in a position to raise the question as to whether or not the method of allocation of income provided in the statute was a reasonable and proper one.

The Connecticut statute there considered differed in one respect from that here under consideration. As the Court pointed out (p. 117) that tax was in lieu of all other taxes on corporations except the general property tax. Here the tax is strictly an income tax and is in addition to franchise and other taxes.

In addition to this case, the New York franchise tax law, which uses the location of tangible property as one of the factors in allocating income, has been several times considered. In *Alpha Portland Cement Co.* v. *Knapp*, 230 N. Y. 48, 231 N. Y. 516 (certiorari denied, 256 U. S. 702), the New York statute allocated income in accordance with the location of property and of the location of business transacted. But in connection with the allocation of property, investments in the stock of other corporations were limited to ten per cent. of the tangible property of the corporation. This limitation was attacked as unreasonable and unconstitutional, the Alpha Company showing that it had investments in the stock of foreign corporations, and that under the New York rule ninety per cent. of the value of the stocks was excluded from the allocation of assets, while the income from all stocks was included in apportionable income. It also owned bonds outside the State of New York. Interest on the bonds was included in apportionable income, while the value of the bonds was excluded from the allocation of assets.

In the Connecticut statute, as under the North Carolina statute, investments in the stock of other corporations were entirely excluded from the allocation. Under the

New York statute they were limited to ten per cent. of the tangible property. The New York Court of Appeals held the statute arbitrary and unreasonable, and that in the case of the Alpha Portland Cement Company it resulted in an unconstitutional taxing of property beyond the jurisdiction of the State.

In the majority opinion Judge CARDOZO said at page 58:

> "I am unable to avoid the conclusion that a method of apportionment which purposely ignores realities, which compels an assessor to look to some of the assets only and close his eyes to all the others, is arbitrary and unreasonable in its increase of the local burden."

On a motion by the State for reargument before the New York State Court of Appeals, the decision of this Court in the *Underwood* case was pressed as a reason for changing the original decision of the State Court; and in a supplementary opinion the New York Court of Appeals held that there was nothing in the *Underwood* case that conflicted with the decision of the New York Court (231 N. Y. 516). Thereafter the State of New York applied to this Court for a writ of certiorari, which was denied (256 U. S. 702).

In the case at bar we have shown (*supra*) that the appellant received dividends from the stock of corporations owned by it which had no relation to North Carolina and it also received interest on securities owned outside of North Carolina. The amount of these dividends and interest was included in the total net income of the appellant, so that eighty per cent. thereof was taxed by North Carolina. The value of the Company's investment in these stocks and interest-bearing securities, all of which are located outside of North Carolina, were entirely dis-

regarded in the allocation of assets. This was the precise situation in *Alpha Portland Cement Company* v. *Knapp*, (*supra*) and were the two grounds upon which the New York Court of Appeals held the New York tax invalid under the Federal Constitution. This is also the ground upon which this Court held the Oklahoma statute invalid in *Oklahoma* v. *Wells Fargo*, 223 U. S. 298. In that case this Court held it was unconstitutional to take into account valuable property situated outside of the State in order to increase proportionately the value of property within the State. It is true that in the case at bar the amount of income thus wrongfully subjected to tax is not large, but if the tax violates the constitutional guarantees this Court has settled that the amount of the illegal burden is immaterial. Thus in *Looney* v. *Crane*, 245 U. S. 178, the Court said:

> "It is thus manifest on the face of all of the cases that they in no way sustained the assumption that because a violation of the Constitution was not a large one it would be sanctioned, or that a mere opinion as to the degree of wrong which would arise if the Constitution were violated was treated as affording a measure of the duty of enforcing the Constitution."

In *Alpha Portland Cement Co.* v. *Massachusetts*, 268 U. S. 203, at page 218, the Court said:

> "The amount demanded is unimportant when there is no legitimate basis for the tax. So far as the language of Baltic Mining Co. *v.* Massachusetts, 231 U. S. 68, 87, tends to support a different view it conflicts with conclusions reached in later opinions and is now definitely disapproved."

The New York statute was also considered in *Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U. S. 271.

The opinion in that case pointed out that the New York allocation of income was not upon the basis of location of tangible property alone, but included other factors. In affirming the judgment sustaining the tax this Court said at page 283:

> "It is not shown in the present case, any more than in the *Underwood* case, that this application of the statutory method of apportionment has produced an unreasonable result. The fact that the company may not have had any net income upon which it was subject to payment of income tax to the Federal Government obviously does not show that it received no net income from the business which it carried on in New York. There is no evidence in the record as to whether the company received any net income from its New York business, or the amount of the profit and loss on that business, if any, either considered separately or in connection with the manufacturing business carried on in Great Britain."

The same New York statute was also attacked in *Gorham Mfg. Co.* v. *Tax Commission*, 266 U. S. 265. The taxpayer in that case did not pursue the administrative remedies provided in the statute, but sued for an injunction in the United States District Court upon the ground that under the facts in that case the New York rule of allocation subjected to tax a greater amount of income than actually had its source in New York. This Court declined to consider this question on the record in that case, saying at page 269:

> "We are of the opinion, however, that, without reference to these constitutional questions, the bill was properly dismissed by the District Court because of the failure of the Company to avail itself

of the administrative remedy provided by the statute for the revision and correction of the tax."

These are the only cases in which the reasonableness of a statutory allocation of income has been considered by this Court for that question was not involved in the recent case of *Educational Films Corporation* v. *Ward* (*supra*). The *ratio decidendi* of these cases seems to indicate that an allocation of income upon a fixed statutory formula is invalid as applied to a taxpayer who shows that as to him the statute produces an unjust result. They certainly are not authority for saying that the statutory formula here in question is constitutional when construed to allocate eighty per cent. of income, and when the taxpayer shows that only seventeen per cent. of income had its source in the State. The most that the respondent can claim for these decisions is that in such case the constitutional question is an open one.

While it may be that the mere fact that in the case at bar eighty per cent. of the income was allocated under the statute, while in fact only seventeen per cent. of the income had its source in the State, does not without further facts or consideration establish the invalidity of the statute and the arbitrary nature of the allocation, it is at least persuasive evidence to that effect.

If the disregard of realities in the case of the appellant was caused by an exceptional combination of circumstances not reasonably to be anticipated, the statute might be good and the result merely the appellant's misfortune. But in the appellant's case the radically unfair results are not due to any unusual or extraordinary circumstances. The evidence shows that substantially similar results have occurred in each of the four years in question, and an analysis of the appellant's business shows

that these arbitrary and unfair results are the natural result of the statutory allocation. Under these circumstances, the fact that the statute taxes more than three times, and perhaps more than four times, as much income as actually has its source in the State is persuasive evidence as to the arbitrary character of the statutory allocation.

The appellant occupies and operates two factories—one in North Carolina and one in New York. It so happens that it owns the factory in North Carolina, and that it rents the factory in New York. So far as the source of income is concerned, it is clear that the incident of the character of occupation, whether of ownership in fee or an occupation as a tenant, does not affect the business transacted. If the appellant owned its New York factory and rented its North Carolina factory, the character of its business so far as North Carolina is concerned would remain unchanged. The difference would be merely that some one else would pay the real estate taxes assessed against the North Carolina property which the appellant in this case pays, and yet that casual incident under the statutory allocation makes a difference of more than fifty per cent. of the income tax that North Carolina has assessed against the appellant.

Its factory investment, as shown on the balance sheet in the record, in North Carolina amounts to over one million dollars. This is somewhat more than fifty per cent. of its total tangible assets. Roughly speaking, for a four-year period, the appellant had about two million dollars of tangible assets, which were allocated about $1,600,000 to North Carolina, and $400,000 outside of North Carolina. Now, if the appellant had rented this plant in Asheville, and had owned a plant of similar value in New York, under the statutory formula the Asheville assets would have decreased one million dollars, and the New

York assets would have been increased one million dollars. The resulting allocation would have been $600,000 to North Carolina, and $1,400,000 outside of North Carolina; and less than forty per cent. of the income would have been allocated on that basis to North Carolina.

The value of the factory which the appellant rents in New York is not shown in the record, and its actual value is immaterial. It could readily be equal in value to the value of the North Carolina tannery. The point is that whatever that value may be, because it is rented and not owned, it is excluded from the computation; and, similarly, if the North Carolina factory had been rented and not owned, it would have been excluded from the computation.

The record shows that the appellant holds certain bark lands of the value of $40,000 as a reserve of bark lands located in North Carolina. No bark or timber has been cut upon them, and no income received from them during any of the years in question (R. p. 111). They represent entirely a dead asset and have had nothing to do with the appellant's business. And yet under the statutory allocation these dead lands have a material influence on the amount of income which is allocated as having its source in North Carolina. If these reserve lands had been owned over the border in Tennessee, they would have operated to reduce the income allocated to North Carolina. Obviously, they have nothing to do with income in either event. Their inclusion as a controlling factor is wholly arbitrary.

This Court has defined income as "the gain produced from capital or labor or both combined." (*Eisner* v. *Macomber*, 252 U. S. 189, 207.) An allocation of income as to source to be a reasonably correct allocation must take account of the actual and ordinary sources of income.

Capital is ordinarily a productive source of income. If a statutory formula was broad enough to make a fair allocation of the ordinary business and took into account the ordinary sources of income, then the fact that one of the factors entering into the computation was the location of capital might not invalidate the apportionment, even though it was shown in an individual case that in fact a certain portion of that capital was not at a certain time producing income. But when the allocation is based *solely upon the location of capital*, and furthermore is limited, not to the location of all capital, but merely to the location of a certain particular kind of capital (that is, tangible assets as distinguished from intangible), then the arbitrary nature of the allocation becomes apparent; and the illustration that much of this capital is often non-income producing is evidence of the arbitrary character of the statutory rule.

It is apparent that in any manufacturing business the income or profit represents the gain from capital which is invested in varying proportions in tangible and intangible assets, and also from the labor expended by the employes of the corporation. The North Carolina rule wholly disregards the allocation of labor as entering into the production of income; and it wholly disregards the use of the capital invested in intangible assets, such as stocks, bonds, accounts receivable, etc.

The North Carolina statute expressly provides that the apportionable income of a foreign corporation includes not only income arising from the use of tangible property, but also interest and dividends—that is, income received from intangible property and from any other source whatever. The tax is levied on a proportion of the total income determined by the location of tangible property. In the case of foreign corporations, investments in stocks

and bonds would normally have no relation to the business in North Carolina. By disregarding the location of these investments in determining the proportion of total income to be taxed, and by including the income from these investments in the tax base, the statute in fact imposes a tax upon these investments which may be wholly without the State's jurisdiction. Often the income from such investments is very large, and may well be greater than the total income from manufacturing or merchandising. In the case at bar we have shown that a portion of the income here taxed was of this character.

The inevitably unjust and arbitrary character of the statutory rule of allocation based upon tangible assets alone appears in almost any hypothetical case. Thus, suppose a trading company that does no manufacturing, and which operates two stores, one in North Carolina and one in Tennessee. The profits of each store are separate and distinct and easily ascertainable. They depend, of course, primarily on the volume of business done and on the rate of profit. If the North Carolina store has made an unwise purchase of slow-selling goods, it will have on hand a large amount of tangible property and will have small profits. If the Tennessee store has bought popular goods, it will move its inventory quickly, will have on hand a small amount of tangible goods, and will have large profits. This is not an exceptional case, but is a common rule in commercial business. In such a case the profits are in inverse ratio to the location of tangible property.

In the case at bar the larger part of appellant's profits come from its retail sales in New York. These profits have no relation to the tangible property in North Carolina. There is a manufacturing business in North Carolina, and in New York a manufacturing business and a

retail merchandising business. Each is to a considerable extent independent of the other. The tangible property in one State has no direct connection with the profits in the other.

The fact is that in most businesses conducted in different places there is no necessary or direct ratio between the profits and the location of tangible assets. It is submitted that if in any case the two ratios are in fact similar, such relationship is wholly fortuitous and not at all causal.

Business experience establishes the fact that profits have no fixed or constant relation to capital, least of all to any particular kind of capital. There are many factors that enter into the ultimate result of business profit or net income. Two concerns in the same business and starting with the same capital will usually have widely different profit results. One prospers, and the other goes into bankruptcy. Obviously, capital is not the sole source of income. Still more is this the case if the comparison is limited to tangible capital. Any business concern, in addition to its fixed investment in tangibles, must have working capital represented by cash in bank, investments, and accounts receivable. A large fixed investment in plant with inadequate working capital is an indication of weakness, and not of strength. It is elementary that in the analysis of corporation reports from the investment standpoint, two factors are controlling: (1) the earning capacity or income, (2) the quick asset position, especially with reference to intangibles. The value of tangible assets is ordinarily accorded very little weight in an investment study.

The fact, then, that business experience shows that tangible capital has no uniform or fixed relation to income, and that investment experience shows that tangible capital is of relatively slight importance in determining

investment value, is further indication of the essentially arbitrary character of the North Carolina allocation.

No statutory allocation can be upheld against a taxpayer as to whom it works an unjust result unless the rule itself contains a necessary causal relation between the measure and the result. The mere fact that it may be fair in some cases is not enough. That would save it in the absence of showing an unjust result in the particular case, but that is all.

The tax statutes in question, in making the allocation, disregard the actual source of income and proceed according to a wholly arbitrary rule. The statutory rule has not only a tendency, but almost a certainty of creating inequality. It is well settled that rules of apportionment must be such as will result in substantial equality as between members of the same class.

Gast Realty Company v. *Schneider Granite Co.*, 240 U. S. 55;
Airway Corporation v. *Day*, 266 U. S. 71.

We submit that both upon reason and upon authority the North Carolina tax statute here in question is arbitrary and unreasonable and is not founded on reasonable probabilities. It taxes income without regard to its source and thus in the case of a foreign corporation it tends to tax income having its source outside of the jurisdiction of North Carolina. In the case at bar this tendency has ripened into actuality. Under the statutory rule of apportionment, four times as much income has been subjected to tax as has its source in the State of North Carolina. It is submitted that the statute is repugnant to the provisions of the Fourteenth Amendment to the Federal Constitution as arbitrarily depriving appellant of its property without due process of law.

POINT IV.

The North Carolina Revenue Acts of 1923 and 1925 as construed and applied to appellant are invalid and unconstitutional, because repugnant to the commerce clause of Section 8, Article I of the Constitution of the United States as involving a burden upon appellant's interstate commerce.

The argument that the tax is repugnant to the Commerce Clause of the Federal Constitution follows as a corollary from what has been said in the preceding point in connection with the due process clause of the Fourteenth Amendment.

It is well settled that a state cannot, under the Federal Constitution, lawfully impose a tax which is a direct burden on interstate commerce. This is so even when the State has personal jurisdiction over the taxpayer. It is upon this principle that taxes on gross receipts received in interstate commerce have been held invalid.

Crew Levick Co. v. *Penn.*, 245 U. S. 292;
Kansas City R. R. Co. v. *Botkin*, 240 U. S. 227;
U. S. Express Co. v. *Minnesota*, 223 U. S. 335;
Galveston Ry. Co. v. *Texas*, 210 U. S. 217.

It is also settled that where a state has personal jurisdiction over a taxpayer, it can lawfully assess an income tax against him measured by his entire net income, even though all or a large part of that income was derived from interstate commerce. This is true, because a tax on net income, where there is jurisdiction over the taxpayer, is considered to be so far removed from the inter-

state commerce that produces the gross income as not to constitute a burden on that commerce.

U. S. Glue Co. v. *Oak Creek*, 247 U. S. 321;
Peck & Co. v. *Lowe*, 247 U. S. 165.

But it follows that where there is no personal jurisdiction over the taxpayer, and jurisdiction to tax rests upon the business done, a tax on net income derived from interstate commerce is invalid under the Commerce Clause; and the fact that the tax is measured by net income and not by gross receipts does not save the tax, because in such case the subject taxed is interstate commerce, on which the tax is thus a direct burden.

Alpha Portland Cement Co. v. *Massachusetts*, 268 U. S. 203.

The general rule as to when a state tax is repugnant to the Commerce Clause has been covered by so many decisions of this Court that we venture to submit the following as a summary statement applicable to the facts in this case:

> *A state having the admitted power to impose a franchise tax on a foreign corporation can measure that tax in any proper or suitable way, as by a tax on the net income of the company derived from its business within a state. But in such cases there must be some reasonable relation between the measure of the tax and the subject taxed.*
>
> *A tax of a given per cent. of the entire net income of a foreign corporation doing both a local and interstate business in several States, although declared by the State imposing it to be merely a*

charge for the privilege of conducting a local business therein, is essentially and for every practical purpose a tax on the entire business of the corporation, including that which is interstate, and this because the entire net income of the corporation represents all its business of every class and wherever transacted. Such a tax is void because in disregard of the Commerce Clause.

International Paper Co. v. *Massachusetts*, 246 U. S. 135;
Looney v. *Crane*, 245 U. S. 178;
Fargo v. *Hart*, 193 U. S. 490;
Oklahoma v. *Wells Fargo Co.*, 223 U. S. 298;
Pollock v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601.

In the case at bar appellant's evidence shows that in fact a large part of its income is directly derived from interstate commerce, and that most of its sales are made in interstate commerce (R. pp. 98, 101, 134). If the appellant's contentions in the foregoing points are well founded, and if the North Carolina rule in fact in its application to the particular facts of the appellant's business and as a matter of reasonable probability as to other corporations results in taxing a very much larger percentage of net income than has its source in the business done and property owned in North Carolina, the tax constitutes a direct burden on interstate commerce and is invalid under the Commerce Clause as well as under the due process clause of the Fourteenth Amendment.

POINT V.

The North Carolina Revenue Acts of 1923 and 1925 are invalid and unconstitutional, because repugnant to the Fourteenth Amendment to the Constitution of the United States in that they arbitrarily deprive appellant of equal protection of laws.

The North Carolina law here drawn in question makes a classification of foreign corporations which the appellant says is arbitrary under the equal protection clause of the Fourteenth Amendment.

Section 201 of the statute in question imposes an income tax on every foreign corporation doing business in the State equivalent to three per cent. in 1923 and four per cent. in 1925 of a proportion of its entire income to be determined according to the following rules:

> "(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible (personal) property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of incumbrances thereon.
>
> "(b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in

this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State."

It will be observed that the statute arbitrarily classifies corporations into two kinds. As to one, the tax is apportioned in accordance with the location of tangible property within and without the State, and in the other case the tax is apportioned in accordance with the gross receipts of the corporation within and without the State.

We are not here concerned with which of these two rules of apportionment is the fairer. It is probable that in the case of an ordinary business corporation a tax in proportion to gross receipts is much more likely to be a fair tax on the profits than a tax based upon the location of tangible property, which may or may not have any direct relation to production of income. But the point here raised is that the classification is in fact wholly arbitrary.

Let us assume two corporations. One is engaged in the purchase and sale of groceries; it operates a store in North Carolina; and it operates a store in Tennessee. The tax as to it is on that portion of the entire income that the value of the tangible property owned in North Carolina bears to its total tangible property. If it happens to own the store in North Carolina and to rent the store in Tennessee, the proportion of total income taxed to North Carolina is very large and is entirely irrespective of the volume of business transacted respectively at the two stores.

The other corporation is engaged in selling stocks and bonds. It also maintains a place of business in North

Carolina and in Tennessee; and in each State it is doing a local business, just as in the case of the grocery corporation. It also owns business premises in North Carolina, and it rents its premises in Tennessee. But the ownership of this property in North Carolina does not influence the imposition of a tax against it. As to it the tax is directly in proportion to the volume of business done at the two stores respectively. As to the corporation that is dealing in intangible property the tax is directly apportioned in accordance with the business done. As to the corporation that is dealing in tangible property the tax wholly disregards the volume of business done, and bases a tax wholly upon the chance or incident as to the location of property owned as distinct from property occupied or used in the business.

In previous points we have discussed the contention that the allocation of income in accordance with the location of tangible property is an arbitrary rule that inevitably tends to produce an unfair and incorrect result. Here we confine ourselves to pointing out that the classification in the statute with two entirely different methods of apportionment is also arbitrary and unreasonable, and that in the case of the appellant this arbitrary rule results in subjecting it to a vastly larger tax than it would have been subjected to if it had fallen under the classification of a corporation dealing in intangible property. The record shows that if the tax were apportioned on the basis of gross receipts, less than two per cent. of its income would be apportioned to the State of North Carolina. The appellant concedes that such an apportionment would be unduly favorable to it, but that is the apportionment that the statute provides for a large class of corporations, and the appellant submits that there is no valid

basis of classification in the difference and condition that justifies this radically different basis of determination of the income to be subjected to tax. The whole scheme of the statute based on this arbitrary classification is invalid, because repugnant to the equal protection clause of the Fourteenth Amendment.

The power of the Legislature to classify subjects of taxation is, of course, very wide, but it is not unlimited, and it cannot lawfully be exercised in an arbitrary or capricious way. *Royster Guano Co.* v. *Virginia*, 253 U. S. 412, 415. Where the Legislature attempts a classification which is founded on unreasonable recognition of differences in condition as affecting taxation, the law and the classification resulting therefrom is invalid. An arbitrary classification is repugnant to the Fourteenth Amendment as depriving a taxpayer, who is penalized by that classification, of the equal protection of the laws guaranteed to it under the Fourteenth Amendment. An extensive citation of authorities for this general rule is unnccessary. It is illustrated in four representative causes.

Gast Realty Co. v. *Schneider Granite Co.*, 240 U. S. 55.

Here was drawn the question of validity of an ordinance of the City of St. Louis, assessing the cost of paving a street against adjoining property owners. The assessment was directed to be based on length of the fronting land without providing for an equal depth of the assessment districts. The law was attacked and held invalid as depriving taxpayers of the equal protection of the laws in that the classification of taxpayers was arbitrary. The Court said at page 58:

> "But * * * if the law is of such a character that there is no reasonable presumption that substantial justice generally will be done, but the probability is that the parties will be taxed disproportionately to each other and to the benefit conferred, the law cannot stand against the complaint of one so taxed in fact."

Again the Court said:

> "The defendants' case is not an incidental result of a rule that as a whole and on the average may be expected to work well, but of an ordinance that is a farrago of irrational irregularities throughout. It is enough to say that the ordinance following the orders of the charter is bad upon its face as distributing a local tax in grossly unequal proportions not because of special considerations applicable to the parcels taxed but in blind obedience to a rule that requires the result. And it cannot be said that the ordinance as a whole may be regarded as an individual exception under a rule that promises justice in all ordinary cases."

In *Air-Way Elec. Corp.* v. *Day*, 266 U. S. 71, the Court held an Ohio statute bad as denying equal protection of the laws. It imposed a fixed tax per share upon corporations having stock of no par value. The Court held that the business and property of a corporation having stock of $100 a share par value did not differ essentially from a corporation having stock of no par value, but divided into shares having an asset value of perhaps $5.00 a share. The tax imposed upon the stock of no par value of a fixed amount and generally corresponding to the tax that would be imposed upon a corporation having shares of $100 par value and based entirely upon the num-

ber of shares of stock authorized was held repugnant to the Fourteenth Amendment.

In *Louisville Gas & Elec. Co.* v. *Coleman*, 277 U. S. 32, the Court considered the validity of a mortgage recording tax under the laws of Kentucky. A tax was placed on mortgages running for more than five years; mortgages for less than that term were exempted from the tax. The Court held that the classification was arbitrary, that it placed mortgagors who put mortgages for more than five years on their property at a disadvantage and inequality as compared with those who borrowed money for shorter periods, and condemned the law as invalid under the equal protection clause of the Fourteenth Amendment.

In *Quaker City Cab Co.* v. *Pennsylvania*, 277 U. S. 389, the Court held a statute of Pennsylvania, which levied a tax upon the total receipts of all corporations, domestic or foreign, engaged in transportation business within the State, unconstitutional, because it did not levy this tax upon individuals or partnerships similarly engaged in the transportation business. The Court said at page 400:

> "The equal protection clause does not detract from the right of the State justly to exert its taxing power or prevent it from adjusting its legislation to differences in situation or forbid classification in that connection, 'but it does require that the classification be not arbitrary but based on a real and substantial difference having a reasonable relation to the subject of the particular legislation.' Power Co. *v.* Saunders, 274 U. S. 490, 493."

POINT VI.

The judgment should be reversed.

Respectfully submitted,

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No. 334

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

HANS REES' SONS, INC., *Appellant*

vs.

STATE OF NORTH CAROLINA, ON THE RELATION OF ALLEN J. MAXWELL, COMMISSIONER OF REVENUE, *Respondent*

BRIEF OF APPELLEE ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA

DENNIS G. BRUMMITT,
Attorney General,

FRANK NASH,
Assistant Attorney General.

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ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NORTH CAROLINA

BRIEF AND ARGUMENT FOR APPELLEE

This cause is brought to this court on appeal from the judgment in the Supreme Court of North Carolina, sustaining the Income Tax in question, the opinion to be found in 199 N. C., 42 and (Rec., pp. 156 to 166, inclusive).

The action was originally constituted by appealing from the judgment of the Commissioner of Revenue of North Carolina to the Superior Court of Buncombe County, under the machinery provided in sections 700 and 701 of the Revenue Act of 1925, chapter 101 Public Laws.

In the Superior Court of Buncombe County, the cause was submitted to the court on a waiver of jury trial with the judge to find the facts. The judgment of his Honor is found (Rec., p. 93). The following admissions were made by the Hans Rees' Sons, Inc., in that court (Rec., p. 93):

"It being admitted that the Commissioner of Revenue, in assessing the tax complained of, was following the method set forth in section 311 of the Revenue Act of 1927, chapter 80 Public Laws, and certain sections of the acts of 1923 and 1925, and that the valuation fixed for the real estate and tangible property of the complaining taxpayer, both within and without the State, is admitted to be correct, and that the total net income of the complaining taxpayer, used for the basis of calculation by the Commissioner of Revenue, is admitted to be correct and that the allocation thereof for the purposes of taxation was made in accordance with the method indicated in the statute referred to, etc."

Interpreting these admissions, in connection with the finding of fact and conclusions of law by the Commissioner of Revenue (Rec., pp. 64 to 68, inclusive), we find this situation:

That the complaint of the increased assessment for income taxes of 1923, 1924 and 1925 was based, not upon the unconstitutionality of the act in its application to the appellant, but because the Commissioner of Revenue deducted from the report, as made by the appellant, the value of certain intangibles, which were used in that report to increase

the amount of the property of the appellant, situated without the State.

The effect of this, we submit, is to eliminate from the consideration of this court the amounts claimed to have been illegally assessed in 1923-24-25 and to leave only the amount of $3,651.40 assessed for 1926.

The following is an itemized statement of the whole transaction, so that the court may have clearly before it the figures upon which the Department of Revenue acted:

1923

Income—original return		$ 230,279.40
North Carolina income		131,996.15
Upon investigation, bad debts reclaimed included	$2,552.50	
Dividends allowed as a credit	904.00	
Corrected Income:		231,927.90
Total value of property—original return		1,582,297.99
Total value of property—revised return		1,148,114.14
Original percentage .5732%		
Revised percentage .837 %		
Original tax paid (not protested)		3,959.88
Additional tax paid (Protested)		1,863.73
Interest (Protested)		260.92
Total		$ 2,124.65

1924

Income—original return		$ 253,921.82
North Carolina income		174,063.41
Upon investigation income tax deduction restored to income	$3,959.88	
Corrected Income		178,023.29
Total value of property—original return		2,241,654.94
Total value of property—revised return		1,792,110.61
Original percentage .6855%		
Revised percentage .8589%		
Original tax paid (Not protested)		5,221.90
Additional tax paid (Protested)		1,422.94
Interest (Protested)		13.83
Total		$ 1,536.77

1925

Income—original return		$ 139,043.43
North Carolina income		86,332.06
Upon investigation income tax deduction restored to income	$5,221.90	
Corrected income		91,553.96
Total value of property—original return		2,293,929.85
Total value of property—revised return		2,147,097.13

Original percentage .6209%	
Revised percentage .6632%	
Original tax paid (Not protested)	3,453.28
Additional tax paid (Protested)	435.40
Interest (Protested)	8.71
Total	$ 444.11

1926

Income—original return	$ 106,727.55
North Carolina income	91,286.48
Not investigated:	
Percentage .8553226%	
Tax paid (Protested)	3,651.46

It is thus apparent that all the increase claimed by appellant to the income tax for the various years involved was caused by an application of the act and a proper allocation of net income thus arrived at. There was no complaint of the unconstitutionality of the act, at the time of the first payment for the years 1923-24 and 25. That amounted, in practical effect, to an admission that the act was constitutional in reference to such payment and so, we submit, it could not be unconstitutional against these appellants by reason of the fact that the proper statement of the assessment should produce more revenue, particularly when this proper statement is directly admitted by the appellant in the court below.

THE CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED IN THIS APPEAL

It is provided in section 3 of Article 5, as follows:

"The General Assembly may also tax trades, professions, franchises and incomes: provided the right of tax on incomes shall not in any case exceed 6%, and there shall be allowed the following exemptions, to be deducted from the amount of annual income, to-wit: a married man with wife living with him, or a widow or widower having a minor child or children, natural or adopted, not less than $2000; to all other persons not less than $1000, and there may be allowed other deductions (not including living expenses), so that only net incomes are taxed."

The statute involved is the Revenue Act of 1925, chapter 101 Public Laws. So far as the years 1923 and 1924 are involved, cognate sections of the Revenue Act of 1921, chapter 34 Public Laws and of the Revenue Act of 1923, chapter 4 Public Laws, with cognate sections in each case, are practically identical with the Revenue Act of 1925.

Section 104 of the act declares as follows:

"The general purpose of this act is to impose a tax for the use of the State Government upon the net income for the calendar year 1925 in excess of exemptions herein set out, collectible in the year 1926 and annually thereafter * * * of every foreign corporation and of every non resident individual having a business or agency in this State in pro-

portion to the net income of such business or agency."

Section 201 of the Revenue Act of 1925, the section particularly applicable to the instant case, is as follows:

"Every corporation organized under the laws of this State shall pay annually an income tax, equivalent to four per cent of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to four per cent of a proportion of its entire income to be determined according to the following rules:

"(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of encumbrances thereon.

"(b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

"(c) The words 'tangible personal property' shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money deposits in banks, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt.

"(d) Foreign insurance companies doing business in this State and returning premium receipts to the insurance commissioner and paying the tax upon such premium receipts as provided in section seventy of this act shall be exempt from this tax."

"Net income" is defined in section 300 as follows:

"The words 'net income' mean the gross income of the tax payer less deductions allowed by this act."

Section 301 defines "gross income" as follows:

"The words 'gross income' mean the income of a taxpayer derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid,

or from professions, vocations, trades, business, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, or profits, and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this act, any such amounts are to be properly accounted for as of a different period."

Such section permits deductions set out therein, but these are not material to this appeal.

Section 306, in computing net incomes, allows certain deductions. Stated shortly, some of these deductions particularly applicable to the instant case are:

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including sub section (c) as to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income;

2. Rentals or other payments required to be made as a condition of the continued use or possession for the purposes of the trade

or property to which the taxpayer has not taken or is not to take title or in which he has no equity;

3. All interest paid during the income year on indebtedness;

4. Taxes for the income year, except taxes on income, inheritance taxes and taxes assessed for a local benefit of a kind tending to increase the value of the property assessed;

6. Losses sustained during the income year of property used in trade or business;

8. A reasonable allowance for the depreciation and obsolescense of property used in the trade or business.

It is stated at page 7 of appellant's brief:

"There is no dispute as to the amount of appellant's gross or net income, nor that the computation of the tax was made in conformity to the statute."

So, it may be taken as admitted that all the deductions allowed by the statute have been made and that, therefore, the action of the Commissioner of Revenue, hereinbefore stated, in increasing the amount of the taxes for the years 1923-24 and 25 by refusing to allow the inclusion of intangible property in estimating the value of the property out of the State, under the rule of allocation, and by the exclusion of the deduction claimed for the payment

of income taxes, were all legal and valid rulings by the Commissioner of Revenue.

There can, therefore, be no doubt that the statute itself is constitutional on its face. The counsel of appellant (Rec., p. 6 of their brief) state the question which they conceive is presented to the court on this appeal, as follows: "This case presents a question, heretofore left undecided by this court, whether such statute is arbitrary and unconstitutional when the record shows that it results in fact in an unreasonable and unjust tax and imposes a burden upon a much larger percentage of income than in fact had its source in the state." The statement, thus made, is, in reality, a begging of the question. We deny distinctly that the record shows that the application of the tax in the instant case results in unreasonable and unjust tax and imposes a burden upon a much larger percentage of income than in fact had its source in this State.

We deny distinctly that the record shows either one of these facts assumed to be true in the statement of the question involved.

The defendant's counsel could not contend, in the face of *Underwood Typewriter Co. vs. Chamberlain*, 254 U. S., 113, that this act, on its face, was not constitutional. Their contention, then, presents only the question whether, under the facts contained in the record, the appellant occupied such a peculiar relationship to the statute as to render it unconstitutional to enforce it against it.

STATEMENT OF FACTS RELIED UPON BY APPELLANT AS TAKING IT WITHOUT THE STATUTE.

The appellant is a corporation organized under the laws of New York and having domesticated in North Carolina, conducts a large tannery in or near the city of Asheville, N. C. All its tanning operations are carried on at this tannery. At one time, the appellant had various tanneries elsewhere than in the State of North Carolina. It had, however, given up these before 1923. It did no manufacturing elsewhere than in the State of North Carolina, except that it finished the belt leather partially in North Carolina and partially in New York. Its principal office is located in New York City. Three salesmen travel out from that office, covering the entire United States. It does both a wholesale and retail business in its manufactured products. Its wholesale business consisted largely in goods sold to shoe manufacturers, certain parts of the hide and other various classes of leather-grade leather, and so on. This was usually sold in bulk car load lots. Its retail business consists of the sale of the better portion of the hide which is cut up into smaller pieces. It is finished in various ways and manners and is sold in less than car load lots. This is called "curried special leather."

It maintains in New York, a warehouse, which is supplied from the tannery at Asheville. As a rule, it kept a very small amount of supplies in the New York warehouse. Orders for wholesale shipments

go from the tannery in Asheville. About 40 or 50% of the output of the plant at Asheville is shipped from the Asheville tannery to New York and the other 60% is shipped direct on orders from New York. A very small part of the output of the Asheville plant is shipped to customers within the State of North Carolina.

Much of the evidence relates to the superior purchasing capacity of the appellant by which it secures raw materials, such as hides, etc., and the chemicals which enter into the tanning process, cheaper than the market price. Much is addressed, also, to the fact that the sales of the manufactured product-leather, are largely made out of the State of North Carolina, though all the orders are filled directly from Asheville, or indirectly from the New York warehouse, which is constantly supplied from Asheville. This is accompanied by an attempt to split up its annual income into three parts:

1st. That derived from superior ability to purchase raw material and other material necessary to manufacture leather;

2nd. That derived from the actual sale of the manufactured product, and

3rd. The income derived from manufacturing at Asheville (Rec., pp. 109 to 113, inclusive and 115).

POINTS FOR ARGUMENT

1. This is not such a controversy as would permit the introduction of parol evidence of the class relied upon by the appellant to show that the statute involved is unconstitutional in its incidence upon the appellant.

2. If, however, such evidence was admissible in the instant case, it does not show that the appellant was arbitrarily deprived of his property or that the income assessed was partly derived from transactions without the State or was excessive in such way as to constitute taking of appellants property without due process of law.

ONE

This is not such a controversy as would permit the introduction of parol evidence of the class relied upon by the appellant to show that the statute involved is unconstitutional in its incidence upon the appellant.

The general rule is thus stated in *Powell vs. Pennsylvania*, 127 U. S., 678:

> "The legislative determination of such question (of fact) is conclusive upon the courts, unless it appears upon the face of the statute, or from the facts of which the courts must take judicial cognizance, that the statute infringes rights secured by the fundamental law."

See, also, 6 RCL section 112.

On this appeal, however, there is no attack upon the constitutionality of the statute involved upon its general application. It is, indeed, admitted that it is constitutional and as a matter of fact, this court has held an identical statute constitutional in *Underwood Typewriter Co. vs. Chamberlain*, 254 U. S., 113. The contention is that the appellant is so related to the particular act that the assessment of an income tax upon it, under the rules provided in the statute, results in arbitrariness so unreasonable as to constitute it a taking of its property without due process of law. The burden, of course, was upon the appellant to show this beyond a reasonable doubt, if permitted to show it at all.

Arkansas Natural Gas Co. vs. Railroad Commission, 261 U. S., 379.

Thomas vs. Kansas City So. Ry. Co., Idem, 481.

Missouri Pac. Ry. Co. vs. Boone, 270 U. S., 466.

Panama Ry. Co. vs. Johnson, 264 U. S., 375.

A consideration of the constitutional provision and the statutes of North Carolina, enacted in pursuance thereof in an attempt to tax net income earned in the State, will show that these statutes operate generally upon all such income earned in the State. There is no complaint, on this appeal, of the administration of the act by the appellee, the Revenue Commissioner of North Carolina. He, therefore, in assessing this income tax, was acting upon direct

authority of the statute, which has been adopted as a practical method of arriving at income of foreign corporations manufacturing raw products into finished goods in the State of North Carolina. This statute does not discriminate against non-resident corporations, is not in any sense a burden upon interstate commerce, does not tax property beyond the taxing jurisdiction of the State, nor income not earned in the State, and, consequently, in itself, does not offend against the Fourteenth Amendment.

This court recognizes the fact that no taxing act can be drafted, with mathematical certainty as not to impose some hardship upon property or persons located near its border line. Legislatures cannot be wiser than Providence, who permits the rain to fall upon the just and unjust. No taxing law can be provided, which, in all particulars will operate similarly and equitably upon all the subjects of taxation. These taxing laws being drawn to meet all the conditions that may arise are, from their nature, rough-hewn, not, in the language of St. Paul, "fitly joined together." In nearly all instances, then, if not all, there is an apparent hardship imposed upon particular taxpayers by the very nature of the act itself. Particularly is this true in the enactment and administration of income tax laws. Thus, Judge Brandeis, in a note to *Atlantic Coast Line R. R. Co. vs. Doughton*, 262 U. S., 413, says:

> "The term 'net income' in law or in economics has not a rigid meaning. Every income tax act necessarily defines what is in-

cluded in gross income; what deductions are to be made from the gross to ascertain net income; and what part, if any, of the net income is exempt from taxation. These details are largely a matter of governmental policy. As to them, states differ; and there is apt to be a difference of view in the same states at different times and, at the same time, a different definition of taxable net income for different classes of taxpayers. Obviously such differences in detail do not render obnoxious to the commerce clause a state income tax which is otherwise objectionable."

Again, it is said in *General American Tank Car Corp. vs. Day*, 270 U. S., 367:

"In determining whether there is a denial of equal protection of the laws by such taxation, we must look to the fairness and reasonableness of its purposes and practical operation, rather than to minut differences between its application in practice and the application of the taxing statute or statutes to which it is complementary."

See, also,

State R. R. Tax Cases, 92 U. S., 575.

Traveler's Ins. Co. vs. Commonwealth, 185 U. S., 364.

Shaffer vs. Carter, 252 U. S., 37.

In *Metropolis Theatre vs. Chicago*, 228 U. S., 61, it is said:

"To be able to find fault with a law is not to demonstrate its invalidity * * * The problems of government are practical ones and may justify, if they do not require, rough accommodation—illogical it may be and unscientific."

While the court considers taxing laws from the standpoint of their practical operation, it does so on broad general lines and upholds them when not plainly arbitrary and discriminatory.

St. Louis, etc. R. R. Co. vs. Arkansas, 235 U. S., 350.

Rogers vs. Hennepin County; 240 U. S., 184.

Gen'l Am. Tank Car Corp. vs. Day, 270 U. S., 367.

Minor inequalities and hardships are incident to every system of taxation, but do not render the legislation obnoxious to the Federal Constitution.

So. Ry. Co. vs. Watts, 260 U. S., 519.

Now, in the instant case, the returns for income tax made by the appellant for the years 1923, 24, 25 and 26 appear together with the calculations made by the Department of Revenue (9 to 35 of the record). Those returns show a considerable excess of the fair cash value of real estate and tangible personal property in the State, as compared with its total real estate and tangible personal property wherever located. It should be noticed, just here, that the

effect of the application of the statute to appellant was to make the real and personal property located out of the State a factor in determining the amount of the income tax. Of course the greater amount of this property out of the State would lessen the amount of income tax automatically. There is no complaint, we repeat, by the appellant of the actual administration of the law by the Revenue Department of the State. We submit, therefore, that as the appellant conducted its manufacturing business in North Carolina wholly and the factory was the source of its supplies and the act having been properly applied by the Commissioner of Revenue, none of the evidence offered by appellant was material in the sense that it showed in any way arbitrariness from the necessary operation of the act itself, under the principles hereinbefore stated. In other words, the act having been administered in good faith, the inequalities, if any, complained of by the appellant, were only those which resulted from the operation of a general, though valid, law.

TWO

If, however, such evidence was admissible in the instant case, it does not show that the appellant was arbitrarily deprived of his property or that the income assessed was partly derived from transactions without the State or was excessive in such way as to constitute taking of appellant's property without due process of law.

For two reasons, this is true:

(a) Taking that evidence at its highest value for the appellant, it shows simply that the defendant purchased material—hides—outside of the State of North Carolina at an amount appreciably less than the market price.

(b) That he sold his manufactured product outside of the State of North Carolina; that he could have had these hides tanned under contract by other tanners, consequently, the difference between the actual cost of tanning and the contract price of having it done at other tanneries, constituted the actual earnings of the Asheville tannery.

This is a patent attempt to divide into parts what is essentially one whole. It is to separate the mere incidents from the main factor in the proposition and omit the main factor itself. It is a rather extraordinary suggestion that the profit of the manufacturing corporation, when it does its own manufacturing for the purpose of sale, should be limited by the difference between what it cost it to manufacture and what it would have cost it to have the manufacturing done by another concern under contract. Every purchase of raw material was as a matter of fact, made for the benefit of the factory at Asheville and that factory was the only one operated by appellant. The sale of the manufactured product was made, also, for the benefit of the tannery itself. The manufacture itself, entirely divorced from the purchase of the raw material and the sale of the

manufactured product, would be like Mahomet's coffin, hung up in the air between the heaven of profit and the earth of no profit. The truth is, the purchase of raw material, manufacture of raw material and the sale of the manufactured product are what this court calls "a unitary business."

The court, in *Bass, Ratcliff & Greton vs. Tax Com.*, 266 U. S., 271, at page 282, said:

> "So, in the present case, we are of opinion that as the company carried on a unitary business of manufacturing and selling ale in which its profits were earned by a series of transactions, beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacture resulting in no profits at all until it ends in sale—the State was justified in attributing to New York a just appropriation of the profits earned by the company from such unitary business."

In that case, the plaintiff was a British corporation, engaged in brewing and selling Bass' Ale. All of its brewing was done and a large part of its sales were made in England, but it imported a portion of this product in the United States, which was sold from branch offices only located in New York City.

The Tax Commission of New York undertook to levy a franchise tax upon the corporation measured by levying 3% upon its net income for the preceding year. This net income allocated to the State was to

be determined by the proportion which the aggregate value of specified classes of the assets of the corporation within the State bore to the aggregate value of all such classes of assets wherever located. Its entire net income from all of its business was $2,185,600. The aggregate value of its segregated property wherever located was $3,501,483. The value of its segregated assets in New York was $44,177. Taking the entire net income as a basis for the assessment of the tax, the proportion thereof allocated to New York amounted to $27,537.68. The 3% of this made the income tax which was levied and which the court sustained on the authority of the *Underwood Typewriter Co. vs. Chamberlain*, supra.

An inspection of the North Carolina statute shows on its face that it applies to all corporations. If it is a foreign corporation deriving profits from the manufacture, purchase, sale, dealing in or using tangible property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State is to the fair cash value of its entire real estate and tangible personal property wherever located, is assigned to the State.

The statute, which was passed upon by the Court in the *Underwood Typewriter* case, supra, was very similar to the statute in the instant case, and indeed, the facts in that case are also similar.

The Supreme Court of Connecticut, which first passed upon the constitutionality of the Act, 94 Conn., 47, says, however, that the Connecticut statute

was not an income tax, strictly, but an excise tax for the privilege of doing business in a corporate capacity within the State. This aspect of the case, however, the Supreme Court of the U. S., at page 120, has put one side, as not necessary to reach an adequate conclusion. All the manufacturing by the *Underwood Typewriter Company* was done in the State of Connecticut. It was a Delaware corporation. It had a branch office in other States for the sale, lease and repair of machinery and the sale of supplies. The product manufactured in Connecticut was shipped direct to the branch offices, purchasers and lessees. Its total net profits amounted to $1,336,-586.13. The actual value of its real estate and tangible personal property in Connecticut was $2,-977,827.68. The value of similar property owned by it out of the State was $3,343,155.11. Thus, the proper proportion was 47 per cent. Applying this proportion to its net profits, stated above, from all sources, $629,668.50 was allocated to Connecticut under the statute as having been earned from the business done within the State.

The rate of the tax was 2 per cent. The tax, then, was $12,593.37. The company paid the tax, under protest, and brought suit to recover the whole amount, but the Court denied recovery, holding that the statute, as administered, offended against neither the commerce provisions of the Federal Constitution or the 14th Amendment, the Court saying:

"In support of its objection that business outside the State is taxed, plaintiff rests solely

upon the showing that of its net profits $1,293,643.95 was received in other States and $42,942.18 in Connecticut, while under the method of apportionment of net income required by the statute, 47% of its net income is attributable to operations in Connecticut. But this showing wholly fails to sustain the objection. The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut, and ending with sale in other States. In this, it was typical of a large part of the business conducted in the State. The Legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment, which, for all that appears in this record, reached and was meant to reach, only the profits earned within the State."

Not only do the facts of this case run on a parallel line with those that appear in the record in this appeal, but the reasoning of both the Connecticut Court, and of the United States Supreme Court fit, in a very definite way, the points presented on this appeal and, we submit, they are determinative of them.

THE TAX IN THE INSTANT CASE IS AN INCOME TAX UPON THE USE OF PROPERTY IN THE STATE AND NOT A FRANCHISE TAX

It is noticeable just here that, in North Carolina, there is no ad valorem tax levied for the support of the State. Such tax was eliminated for that purpose in 1921. The Income Tax Law, as hereinbefore quoted, requires the deduction of all taxes paid during the income year. As a consequence, in arriving at that portion of the income of the appellant to be assigned to North Carolina the local taxes paid by it were deducted.

In *Atlantic Coast Line vs. Doughton*, 262 U. S., 413, at page 420, this court calls a similar income tax a tax upon the net income of property, saying:

> "That a state may consistently, with the Federal Constitution, impose a tax upon the net income of property, as distinguished from the net income of him who owns or operates it, although the property is used in interstate commerce, was settled in *Shaffer vs. Carter*, 252 U. S., 37, 44, 52; 40 Sup. Ct., 221; 64 L. Ed. 445. There, an Oklahoma statute was sustained which laid the tax upon the net income of Oklahoma oil property owned by a citizen and resident of Illinois. The Federal Constitution which permits to be taxed the net income of property owned by an individual, although a citizen of another

state, obviously does not include such a tax where the property is owned or operated by a corporation. It is a common provision in State income tax laws to tax the net income of property within the state which is owned, or operated, by non-residents. The differences between the parties arise, in the main, not from difference in the method of determining what is net income, but from difference as to what is the subject of the tax. In other words, they differ as to the thing of which the net income is to be ascertained. This will appear from an examination of the several grounds on which the validity of the statute is assailed."

It is clearly within the constitutional power of a State to levy an income tax on the net incomes earned within the State by persons and corporations engaged in interstate commerce, and that such a tax is not a burden on interstate commerce, and does not violate the commerce clause, because the net incomes taxed may be derived in part or mainly from the business of interstate commerce.

U. S. Glue Co. vs. Oak Creek, 247 U. S., 321.

Shaffer vs. Carter, 252 U. S., 37.

Underwood Typewriter Co., supra.

Travis vs. Yale & Towne Mfg. Co., 252 U. S., 60.

In *Alpha Portland Cement Co. vs. Massachusetts*, 268 U. S., 203, the court held unconstitutional the Massachusetts act, which imposed an excise tax on a foreign corporation for the privilege of doing business in the State, measured by the proportion of capital attributed to transactions within the State, and income derived therefrom when it was applied to a foreign corporation maintaining in the State only a local sales office from which its salesmen solicited orders, subject to approval at the principal office. This, however, was on the ground that the business itself was interstate commerce. The court, however, was careful to explain (Rec., p. 216) that the right to lay taxes on tangible property or on income was not involved. The distinction, so suggested, is brought out clearly by comparing this case with *National Leather Company vs. Massachusetts*, 277 U. S., 413. These cases also tend to illustrate the limits which the court would impose upon itself in permitting evidence in a particular case to show that a general statute, valid on its face, might be unconstitutional in its application to the facts of the particular case.

The injustice of the application, in the particular case, must be apparent and so gross as, in necessary effect, to deprive the particular taxpayer of his property without due process of law or deny to him the equal protection of the laws. The income tax, then, in the instant case, levied upon non-resident corporations in the manner provided in the act and under the circumstances set out in this case, is not an income

tax strictly upon the individual owner, but upon his property located in this State. This property is made a unit by the statute and, as such, pays income tax in accordance with the method provided in that statute. These considerations, we submit, distinguish this case from *Compania General de Tabacos de Filipinas vs. Collector of Internal Revenue*, 279 U. S., 306.

The case of *Wallace vs. Hines*, 253 U. S., 66, is valuable only as showing that the petition in the particular case set out facts which, admitted upon demurrer, justified the three judge court hearing the case to grant a temporary injunction. The mileage rule was adopted by the Legislature of North Dakota, in allocating the excise tax upon railroads in its application to foreign corporations, though the allegations, thus admitted, show that the mileage proportion was grossly unjust in determining the proportion of the property of the road to be allocated to the particular State for taxation. This case should be interpreted in connection with

Southern Railway vs. Watts, 260 U. S., 519.

The defendant's counsel, in their brief (Rec., 57 et seq) relied upon *Alpha Portland Cement Company vs. Knapp*, 230 N. Y., 48 as showing that in the determination of the amount of income from which was to be allocated a certain proportion to North Carolina, the Commissioner of Revenue added to the total amount of net income, dividends from

the stock of corporations owned by it and interest on securities owned outside of the State of North Carolina. The return of the appellant for income tax for the year ending December 31, 1926, is set out by the appellant at (Rec., pp. 31 to 35, inclusive). At the top of page 36 is the statement of dividends received from other than North Carolina corporations for the calendar year 1926—$840. This is the only allusion to such dividends. The rate of income taxes for the year 1926 was 4%. There is no evidence in the record that this was an independent, if not permanent, investment by this company. The rule adopted by the Commissioner of Revenue, under the advice of this office, was that incomes derived from independent, if not permanent, investments by a foreign company in the stocks and bonds of other corporations located in other states was not to be included in the net income derived by the corporation from its business at large, in computing the net income to be allocated to North Carolina.

We submit, therefore, that as the record is made up, this cannot be suggested here as an adequate reason for holding the act unconstitutional in its application to the appellant.

We cannot define cases in which the court may resort to parol evidence to show that a particular statute is unconstitutional in its incidence upon a particular taxpayer.

We merely suggest that no court—State or Federal—including this court, has ever exercised micro-

scopic acuteness in applying the rule to cases before them. There at least must be such gross inequality as to deprive the taxpayer of his property without due process of law or to deny him the equal protection of the laws.

Respectfully submitted,

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FRANK NASH,
Assistant Attorney General.

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SUPREME COURT OF THE UNITED STATES.

No. 334.—October Term, 1930.

Hans Rees' Sons, Inc., Appellant,
vs.
State of North Carolina on the Relation of Allen J. Maxwell, Commissioner of Revenue.

Appeal from the Supreme Court of the State of North Carolina.

[April 13, 1931.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The appellant, Hans Rees' Sons, Inc., a corporation organized under the laws of New York, began this action by an application to the Commissioner of Revenue of the State of North Carolina for the readjustment of the income tax assessed against the appellant by that State. The assessment was for the years 1923, 1924, 1925 and 1926, in accordance with the applicable state laws,[1] and the controversy related to the proper allocation of income to the State of North Carolina. The Commissioner of Revenue made his findings of fact and conclusions of law, the appellant's exceptions were overruled and the prayer for revision of the taxes was disallowed. Appeal, waiving a jury, was taken to the Superior Court of Buncombe County, North Carolina. On the trial in that court, evidence was introduced by the appellant with respect to the course of business and the amount and sources of income for the years in question. The appellant admitted that "(a) in assessing the tax the Commissioner of Revenue followed the statutory method . . .; (b) that the valuation of the real estate and tangible property of the taxpayer 'both within and without the State' is correct; (c) that the total net income used as a basis for the calculation of the tax is correct; (d) that the allocation of the net income for purposes of taxation was in full accord with the statute." The contention of the appellant was that the income tax statute as applied to the appellant, upon the facts dis-

[1]Laws of 1923, chap. 4, sec. 201; 1925, chap. 101, sec. 201; 1927, chap. 80, sec. 311.)

closed, was arbitrary and unreasonable, and was repugnant to the commerce clause and to section 1 of the Fourteenth Amendment of the Federal Constitution. The Superior Court struck out the testimony offered by the appellant, as being immaterial, and held that the statute, as applied did not violate constitutional rights. The judgment dismissing the action was affirmed by the Supreme Court of the State, 199 N. C. 42. The case comes here on appeal.

As to the portions of the taxes for the years in question, which had been paid by the appellant voluntarily and as to which recovery was denied upon that ground, no question is raised here.

The Supreme Court of the State sustained the ruling of the trial court in striking out the evidence offered by the appellant, but held that, if the evidence were deemed to be competent, it would not change the result. The case may therefore be viewed as though the evidence had been received and held to have no bearing on the validity of the statute. *Fairmont Creamery Company* v. *Minnesota*, 274 U. S. 1, 5. The evidence was thus summarized by the state court:

"This evidence tended to show that the petitioner" (the appellant here) "was incorporated in the State of New York in 1901 and is engaged in the business of tanning, manufacturing and selling belting and other heavy leathers. Many years prior to 1923 it located a manufacturing plant at Asheville, North Carolina, and after this plant was in full operation dismantled and abandoned all plants which it had heretofore operated in different states of the union. The business is conducted upon both wholesale and retail plans. The wholesale part of the business consists in selling certain portions of the hide to shoe manufacturers and others in carload lots. The retail part of the business consists in cutting the hide into innumerable pieces, finishing it in various ways and manners and selling it in less than carload lots. In order to facilitate sales a warehouse is maintained in New York from which shipments are made of stock on hand to various customers. The tannery at Asheville is used as a manufacturing plant and a supply house, and when the quantity or quality of merchandise required by a customer is not on hand in the New York warehouse a requisition is sent to the plant at Asheville to ship to the New York warehouse or direct to the customer. The sales office is located in New York and the salesmen report to that office. Sales are made throughout this country and in Canada and Continental Europe. Some sales are also made in North Carolina. Certain finishing work is done in New York. The evidence further tended to show that 'between forty and fifty per cent of the output of the

plant in Asheville is shipped from the Asheville tannery to New York. The other sixty per cent is shipped direct on orders from New York. . . . Shipment is made direct from Asheville to the customer.'

"The petitioner also offered evidence to the effect that the income from the business was derived from three sources, to-wit: (1) buying profit; (2) manufacturing profit; (3) selling profit. It contends that buying profit resulted from unusual skill and efficiency in taking advantage of fluctuations of the hide market; that manufacturing profit was based upon the difference between the cost of tanning done by contract and the actual cost thereof when done by the petitioner at its own plant in Asheville, and that selling profit resulted from the method of cutting the leather into small parts so as to meet the needs of a given customer.

"Without burdening this opinion with detailed compilations set out in the record, the evidence offered by the petitioner tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent."

According to the assessments in question, as revised by the Commissioner of Revenue and sustained, there was allocated to the State of North Carolina, pursuant to the prescribed statutory method, for the year 1923, 83+ per cent. of the appellant's income; for 1924, 85+ per cent; for 1925, 66+ per cent; and for 1926, 85+ per cent.

The applicable statutory provisions, as set forth by the state court, are as follows:

"Every corporation organized under the laws of this State shall pay annually an income tax, equivalent to four per cent of the entire net income as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to four per cent of a proportion of its entire income to be determined according to the following rules:

"(a) In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, purchase, sale of, trading in, or use of tangible property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deductions on account of encumbrances thereon.

"(b) In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

"(c) The words 'tangible personal property' shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise and shall not be taken to mean money deposits in bank, shares of stock, bonds, notes, credits or evidence of an interest in property and evidences of debt."

Relying upon the decisions of this Court with respect to statutes of a similar sort enacted by other States, the Supreme Court of the State held that the statute of North Carolina was not invalid upon its face. *Underwood Typewriter Company* v. *Chamberlain*, 254 U. S. 113, 120, 121; *Bass, Ratcliff & Gretton, Limited*, v. *State Tax Commission*, 266 U. S. 271, 280-283; *National Leather Company* v. *Massachusetts*, 277 U. S. 413, 423. In *Underwood Typewriter Company* v. *Chamberlain, supra*, a statute of Connecticut imposed upon foreign corporations doing business partly within and partly without the State, an annual tax of two per cent upon the net income earned during the preceding year on business carried on within the State, ascertained by taking such proportion of the whole net income on which the corporation was required to pay a tax to the United States as the value of its real and tangible personal property within the State bore to the value of all its real and tangible personal property. All the manufacturing by the corporation was done in Connecticut, but the greater part of its sales were made from branch offices in other States. It was contended that the tax was an unconstitutional burden upon interstate commerce and that it violated the Fourteenth Amendment in that it imposed a tax on income arising from business conducted without the State. In support of the latter objection, the corporation showed that while 47 per cent. of its real estate and tangible personal property was located in Connecticut, almost all its net profits were received in other states. This Court said: "But this showing wholly fails to sustain the objection. The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legis-

lature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which for all that appears in this record, reached, and was meant to reach, only the profits earned within the State. 'The plaintiff's argument on this branch of the case', as stated by the Supreme Court of Errors, 'carries the burden of saying that 47 per cent. of its net income is not reasonably attributable, for purposes of taxation, to the manufacture of products from the sale of which 80 per cent. of its gross earnings was derived after paying manufacturing costs.' The corporation has not even attempted to show this; and for aught that appears the percentage of net profits earned in Connecticut may have been much larger than 47 per cent. There is, consequently, nothing in this record to show that the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result." In this view, the validity of the Connecticut statute was sustained.

In the case of *Bass, Ratcliff & Gretton, Limited,* v. *State Tax Commission, supra,* the State of New York imposed an annual franchise tax at the rate of three per cent. upon the net income of the corporation. The Court, describing the statute, said that "if the entire business of the corporation is not transacted within the State, the tax is to be based upon the portion of such ascertained net income determined by the proportion which the aggregate value of specified classes of the assets of the corporation within the State bears to the aggregate value of all such classes of assets wherever located." The corporation in that case was British, engaged in brewing and selling Bass' ale. Its brewing was done, and a large part of its sales were made, in England, but it had imported a portion of its product into the United States which it sold in branch offices located in New York and Chicago. The Court regarded the question of the constitutional validity of the New York tax as controlled in its essential aspect by the decision in *Underwood Typewriter Company* v. *Chamberlain, supra.* And, referring to the facts of that case, the Court said: "So in the present case we are of opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its

profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business. . . Nor do we find that the method of apportioning the net income on the basis of the ratio of the segragated assets located in New York and elsewhere, was inherently arbitrary or a mere effort to reach profits earned elsewhere under the guise of legitimate taxation. . . It is not shown in the present case, any more than in the *Underwood Case*, that this application of the statutory method of apportionment has produced an unreasonable result."

In the instant case, the state court, having considered these decisions, held that the statute of North Carolina was valid upon its face, sought to justify its view that the evidence offered by the appellant was without effect, upon the following grounds:

"The fallacy of this conclusion" (that is, the appellant's contention that the application of the statute had been shown to be unreasonable and arbitrary, and hence repugnant to the Federal Constitution) "lies in the fact that the petitioner undertakes to split into independent sources, income which the record discloses was created and produced by a single business enterprise. Hides were bought for the purpose of being tanned and manufactured into leather at Asheville, North Carolina, and this product was to be shipped from the plant and sold and distributed from New York to the customer. The petitioner was not exclusively a hide dealer or a mere tanner of leather or a leather salesman. It was a manufacturer and seller of leather goods, involving the purchase of raw material and the working up of that raw material into acceptable commercial forms, for the ultimate purpose of selling the finished product for a profit. Therefore, the buying, manufacturing and selling were component parts of a single unit. The property in North Carolina is the hub from which the spokes of the entire wheel radiate to the outer rim." And, in its final conclusion, the state court said that, if it were conceded that the evidence offered by the appellant was competent, still, as it showed that the appellant "was conducting a unitary business as contemplated and defined by the courts of final jurisdiction", it was

"not permissible to lop off certain elements of the business constituting a single unit, in order to place the income beyond the taxing jurisdiction of this State."

We are unable to agree with this view. Evidence which was found to be lacking in the *Underwood* and *Bass* cases is present here. These decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State. In the *Underwood* case, it was not decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the *Bass* case, that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the *Underwood* case, "for all that appears in the record, reached, and was meant to reach, only the profits earned within the State." The difficulty with the evidence offered in the *Underwood* case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that State; and in the *Bass* case the court found a similar defect in proof with respect to the transactions in New York.

Undoubtedly, the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits. The difficulty of making an exact apportionment is apparent and hence, when the State has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases. But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as "component parts of a single unit" so that the entire net income may be taxed in one State regardless of the extent to which it may be derived from the conduct of the enterprise in another State. As was said in the *Bass* case with regard to "the unitary business of manufacturing and selling ale" which began

with manufacturing in England and ended in sales in New York, that State "was justified in attributing to New York its proportion of the profits earned by the Company from such unitary business." And the principle that was recognized in *National Leather Company* v. *Massachusetts, supra,* was that a tax could lawfully be imposed upon a foreign corporation with respect to "the proportionate part of its total net income which is attributable to the business carried on within the State." When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a State has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction.

Nor can the evidence be put aside in the view that it merely discloses such negligible criticisms in allocation of income as are inseparable from the practical administration of a taxing system in which apportionment with mathematical exactness is impossible. The evidence in this instance, as the state court puts it, "tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent.", while under the assessments in question, there was allocated to the State of North Carolina approximately eighty per cent. of the appellant's income.

An analysis has been submitted by the appellant for the purpose of showing that the percentage of its income attributable to North Carolina, for the years in question, did not in any event exceed 21.7 per cent. As pointed out by the state court, the appellant's evidence was to the effect that the income from its business was derived from three sources, buying profit, manufacturing profit, and selling profit. The appellant states that its sales were both wholesale and retail; that the profits from the wholesale business were in part attributable to the manufacturing in Asheville and in part to the selling in New York, but that the appellant's accountants made no attempt to separate this, and that the entire wholesale profit was credited to manufacturing and allocated to North Carolina. Similarly, it is said that no attempt

was made to separate profits from manufacturing in New York from profits derived from manufacturing in Asheville, and that all manufacturing profits were allocated to North Carolina. It is insisted that, in the retail part of the business, the leather is cut into small pieces and finished in particular ways and supplied in small lots to meet the particular needs of individual customers, and that this part of the business is essential to the retail merchandising business conducted from the New York office. The so-called "buying profit" is said to result from the skill with which hides are bought and the contention is that these buying operations were not conducted in North Carolina. If as to the last, it be said that the buying of raw material for the manufacturing plant should be regarded as incident to the manufacturing business, and as reflected in the value at wholesale of the manufactured product as turned out at the factory, still it is apparent that the amount of the asserted buying profit is not enough to affect the result so far as the constitutional question is concerned.

For the present purpose, in determining the validity of the statutory method as applied to the appellant, it is not necessary to review the evidence in detail, or to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina. It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the state court with respect to the facts shown, the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view, the taxes as laid were beyond the State's authority. *Shaffer* v. *Carter*, 252 U. S. 37, 52, 53, 57.

For this reason the judgment must be reversed and the cause remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.